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# The Double EMG Distribution and Trade Elasticities\*

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## Abstract

Using Brazilian export data that, unlike many trade data sets, keep a full record of small export sales, this paper reconsiders trade elasticities and the welfare gains from trade. Using the Brazilian data, this paper provides novel evidence on the properties of the distributions of log-export sales and shows that the Double Exponentially Modified Gaussian (EMG) distribution parsimoniously captures these properties. Using the Double EMG distribution in a standard monopolistic competition model of trade, this paper demonstrates that data truncation, that is prevalent in many data sets, leads to an upward bias in measuring the partial elasticity of trade with respect to variable trade costs. This bias subsequently leads to the underestimation of the gains from trade by 1% to 9% depending on the extent of data truncation, a range that is commensurate with typical economic growth and large booms.

**Keywords:** Trade elasticities, firm size distribution, extensive margin, Exponentially Modified Gaussian distribution

**JEL Codes:** F12, L11

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# 1 Introduction

Recent advances in new trade theory develop a straightforward method to evaluate the welfare gains from trade. Most notably, [Arkolakis, Costinot, and Rodriguez-Clare \(2012\)](#) show that a researcher only needs to know two sufficient statistics in order to measure the welfare gains from trade: the share of a country’s expenditure on domestically produced goods and a partial elasticity of trade flows with respect to variable trade costs. While the share of expenditure on domestic goods can be computed from the aggregate data that are often publicly available, a more rigorous analysis is needed to infer the value of the partial trade elasticity. In particular, as shown in [Melitz and Redding \(2015\)](#), to estimate the partial trade elasticity a researcher needs to observe the entire distribution of log-export sales including the export sales of the smallest exporter.

The challenge in measuring the partial trade elasticity often lies in an inability to empirically observe the entire distribution of log-export sales. For example, exporters may not be required to report export sales below a given threshold, as is the case for frequently used European Union export data. This threshold can vary from as low as 700 euros for intra-EU trade with Malta to as large as over 1 million euros for intra-EU trade with Belgium, Netherlands, or the United Kingdom ([EUROSTAT, 2017](#)). When a portion of export sales transactions are missing from the data, the econometrician will be unable to correctly infer the underlying distribution of log-export sales and the export sales of the marginal exporter. As a result, the partial trade elasticity would be mismeasured and, therefore, so would the gains from trade.

In this paper, we examine Brazilian export data that, unlike many trade data sets, keep a full record of small export sales. We provide novel evidence on the properties of the distribution of log-export sales; show that a Double Exponentially Modified Gaussian (EMG) distribution parsimoniously captures these properties; quantify trade elasticities derived from a trade model with heterogeneous firms that features the Double EMG distribution; and show that data truncation leads to overestimation of the partial trade elasticity and underestimation of the gains from trade. This paper proceeds as follows.

First, using Brazilian export data, we document new empirical evidence of asymmetry within log-export sales distributions. The two novel forms of asymmetry that stand out from the data are (i) substantial heterogeneity in positive and negative skewness across log-export sales distributions and (ii) the prevalence of a large mass of firms (power laws) in the *left* tails in log-export sales distributions. For comparison, we recompute our statistics for a sample in which we drop firm export sales below a given threshold and find that properties of truncated log-export sales distributions resemble those found in previous work that relies

on truncated data sets.

Second, we introduce the *Double Exponentially Modified Gaussian* (Double EMG) distribution and show that the distribution can parsimoniously capture the prevalent asymmetry and tail fatness in the empirical log-export sales distributions. The Double EMG distribution is constructed as a sum (convolution) of independent Normal and Double Exponential distributions. The Normal component of the distribution leads to a bell-shaped distribution, which is a common property of empirical log-export sales distributions. The Double Exponential component leads to varying mass (fatness) in the right- versus left-tails of the Double EMG distribution. We subsequently fit the Double EMG distribution to empirical log-export sales distributions across export destinations. We find that the Double EMG distribution matches the micro-data better than a number of alternative distributions considered in the literature, namely the Normal and Exponential distributions, across various measures of goodness-of-fit.<sup>1</sup>

It is worth noting that the Double EMG distribution is appealing on theoretical grounds. We show that the Double EMG distribution arises naturally in trade models with heterogeneous firms, along the lines of Melitz (2003) in which firms face supply and demand side heterogeneity. In particular, when firms draw their productivity parameter from a (Double) Pareto distribution (see Chaney (2008)) and simultaneously draw their demand parameter from a Normal distribution (see Timoshenko (2015)), the resulting cross-sectional distribution of log-sales follows a Double EMG distribution.<sup>2</sup>

Third, we quantify partial trade elasticities using a structural trade model that features firm heterogeneity and a Double EMG distribution. We find that there exists little variation in model generated trade elasticities, despite the empirically observed heterogeneity in log-export sales distributions. In fact, the quantified differences in the model generated partial trade elasticities are negligibly small and effectively yield a single trade elasticity across all destinations, as in the Krugman (1980) model of trade where all firms are identical and there is no selection. This finding implies that the contribution of selection to changes in trade flows as a result of changes in variable trade costs, known as the extensive margin of the partial trade elasticity, is inconsequential (on the order of magnitude of  $10^{-5}$  according to

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<sup>1</sup>Note that when the distribution of log-sales follows a Normal distribution, the distribution of sales follows a log-Normal distribution. Similarly, when the distribution of log-sales follows an Exponential distribution, the distribution of sales follows a Pareto distribution. The two representations are isomorphic. Given that we characterize properties of the log-export sales distributions, we adopt the Normal and Exponential representation.

<sup>2</sup>More generally, the Double EMG distribution's microfoundations can be traced to the literature on firm size dynamics and power laws (see Gabaix (2009) for an extensive review). Reed and Jorgensen (2004) and Toda (2014) prove that the (Double) EMG is the endogenous steady state distribution of a Brownian motion that is subject to a Poisson process over stopping times (exits) and whose initial points are Normally distributed.

our results).

The insignificance of selection is driven by the abundance of small firms in the log-export sales distribution. Our identification strategy for quantifying the trade elasticities closely follows Bas et al.'s (2015) and relies on (i) using the entire shape of the empirical distribution of log-export sales, in particular the left-tail of the distribution, to identify a theoretical distribution of log-export sales and (ii) using information about the sales of a marginal exporter to identify the market entry threshold. In our sample, the average smallest exporter in a trade destination has approximately \$160 in sales, which typically comprises only 0.06% of the sales from the average exporter. The low sales of marginal exporters makes their contribution to trade small. As a result, the adjustment in trade to changes in variable trade costs is overwhelmingly driven by changes in sales of incumbent firms, which is known as the intensive margin of the partial trade elasticity.

Fourth, we quantify the magnitude of the bias in measured trade elasticities arising from omitting the small firms in the data. We refer to this phenomenon as *truncation bias*. To quantify this truncation bias, we create a set of counterfactual data sets by applying a truncation rule to our original data. Specifically, we drop all firm export sales records if they fall below a specified threshold. We find that in the truncated samples, partial trade elasticities no longer equals the intensive margin of the partial trade elasticity (as in Krugman (1980)). Instead, the average partial trade elasticity increases by up to 14% and the standard deviation across destinations increases from  $10^{-4}$  to 1.33. Therefore the truncated sample elasticity estimates exhibit much larger heterogeneity across country-pairs compared to the full sample elasticity estimates.

The truncation bias in measuring partial trade elasticities is solely driven by assigning a falsely greater role to firm entry and exit (i.e. the extensive margin) in overall trade. The structural estimation of partial trade elasticities relies on the sales of the smallest exporter to identify the size of entrants and exiters (the market entry threshold and, therefore, the extensive margin). Because data truncation artificially increases the size of a marginal exporter, truncated samples will overestimate the role of entry and exit in generating trade flows and induce larger partial trade elasticities. Our results therefore suggest that when the micro data are used to quantify partial trade elasticities, frequently used data sets that feature sample truncation will necessarily overstate the role of selection.

Finally, we show that truncation bias in measuring partial trade elasticities leads to an underestimation of the welfare gains from trade. To quantify the effect of truncation bias on welfare gains, we perform a series of counterfactual experiments in a general equilibrium setting. In the benchmark exercise, we calibrate model parameters to ensure the model's partial trade elasticity equals that from the full data sample. In a counterfactual exercise,

we calibrate model parameters to match the partial trade elasticity that was estimated from truncated data. We then compute welfare changes (measured as changes in aggregate real income in the model) from declines in trade costs and compare these welfare changes in the benchmark calibration and the counterfactual calibration. We find that a 0.3% to 14% overestimation of partial trade elasticities from truncation bias leads to a 1% to 9% underestimation of the welfare gains from a 50% decline in trade costs.

The economic significance of these magnitudes is striking when the lower bound of 1% is contrasted with the past decade of GDP growth in the U.S. of 2% per year, or the past three decades of Brazilian GDP growth of 2.5% per year; or when the upper bound of 9% is contrasted with the past two decades of Chinese GDP growth of 10% per year.<sup>3</sup> The implication is that a truncated sample leads to underestimated welfare gains to trade by magnitudes that range from a typical GDP growth experience to a large economic boom.

The main results of this paper suggest that the welfare implications of structural trade models along the lines of Melitz (2003) are sensitive to the existence of small firms. When identifying trade elasticities from log-export sales distributions, the partial elasticity of trade flows with respect to variable trade costs almost entirely reflects the increased export sales of incumbent firms. The contribution of selection or firm turnover, through the extensive margin of the partial trade elasticity, is approximately zero because it is identified by smallest exporter whose export sales are merely 0.06% as large as that of an average exporter. However, this result does not imply that the firm turnover is small. In fact, it can be quite large. These results more simply show that the contribution of entrants' export sales to trade is small relative to incumbents' export sales. Therefore, when data are truncated, the role of the extensive margin of the partial trade elasticity can appear quite large exactly because truncation increases the size of the observed marginal entrant.

**Literature Review:** This paper contributes to several literatures. First is the empirical literature on firm size distributions. Axtell (2001) shows that, when measured in number of workers, the right tail of the U.S. firm size distribution closely follows Zipf's law. Studying the French firm size distribution, di Giovanni, Levchenko, and Rancière (2011) provide further evidence on the estimates of the tail parameter of a Power law distribution and show that it lies close to one. Furthermore, while Cabral and Mata (2003) document a positively skewed firm size distribution over number of employees in Portuguese manufacturing firms and Bastos and Dias (2013) extend this result to total Portuguese exports, our work shows that the asymmetric nature of the data is also pronounced in the distribution of export sales by destination. In the Brazilian export data, the majority of destination-level exports are

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<sup>3</sup>Average annual GDP growth data are taken from the *World Development Indicators*.

positively skewed and the degree of (positive and negative) skewness varies across destination. We demonstrate that a Double EMG distribution can match this feature of the data, while a Normal distribution is symmetric and an Exponential distribution has a constant skewness of 2.

In contrast, recent work has argued that sales distributions are not well characterized by Zipf's law. For example, [Head, Mayer, and Thoenig \(2014\)](#) show that a Normal distribution provides a better fit to export sales data, primarily due to its superior ability to match the left tail of export sales distributions. Furthermore, similar to this paper, [Nigai \(2017\)](#) shows that a mixture distribution of a log-Normal and Pareto better fits aggregated sales data. The Double EMG as a characterization of the firm size distribution, however, has advantages over both the Normal and the mixture distribution. First, neither the Normal nor the mixture distribution is capable of matching negative skewness that we document in the data. Second, the Double EMG has explicit microfoundations, unlike a mixture distribution, which is appealing on the grounds of theoretical consistency within the model.<sup>4</sup> Third, we quantitatively assess the fit of the Double EMG distribution and find that the data favors the Double EMG over either the log-Normal or Pareto.<sup>5</sup>

While this paper introduces the Double EMG to trade models, the Double EMG distribution has also been used in various recent macroeconomic applications. Both [Badel and Huggett \(2014\)](#) and [Heathcote and Tsujiyama \(2015\)](#) use the distribution to model idiosyncratic earnings in incomplete markets models with taxation. The distribution helps capture the skewness in log-earnings distributions, as the EMG fits the cross-sectional log-earnings distribution better than a conventionally used Normal distribution. [Toda and Walsh \(2015\)](#) use the Double EMG to model the distribution of consumption growth in the Consumer Expenditure Survey and estimate consumption-based asset pricing models in the presence of fat-tailed consumption growth.

Our quantitative results are consistent with recent work that finds a small contribution of firm entry and exit to trade flows. In particular, [Gopinath and Neiman \(2014\)](#) find that while the number of importing firms declined by 50% during the first year of the Argentine crisis in the early 2000s, these exiting firms only accounted for less than 8% of the subsequent fall in the value of exports. In contrast, while other work has found a large contribution of entrants to trade flows, these studies cumulate flows over long time horizons of at least a decade. For example, [Goldberg, Khandelwal, Pavcnik, and Topalova \(2009\)](#) find that new

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<sup>4</sup>A further point of departure from [Nigai \(2017\)](#) is a focus on measuring trade elasticities. Relative to that paper and [Head et al. \(2014\)](#) as well, this paper focuses on the rich heterogeneity of sales distributions across destination-years.

<sup>5</sup> While this paper focuses on exogenous distributions governing firm-level heterogeneity, [Mrázová, Neary, and Parenti \(2016\)](#) focus on how preferences influence sales distributions.

HS6 products, which entered between 1987 and 2000, contributed to 65% of the increase in the volume of imports during India’s liberalization between 1987 and 2000. Similarly, [Lincoln, McCallum, and Siemer \(2017\)](#) show that firms who became new exporters during the 13 years between 1987 and 2002 accounted for 54% of the manufacturing export value in 2002. When expressed on a per year basis, these numbers are similar to those in [Gopinath and Neiman \(2014\)](#).

Our paper is also related to work that shows that structural estimation of the partial trade elasticity is a useful alternative to the reduced form gravity approach pioneered by [Tinbergen \(1962\)](#).<sup>6</sup> A key assumption underlying typical gravity equation estimation is that partial trade elasticities are common across bilateral country-pairs. [Melitz and Redding \(2015\)](#) have shown that this assumption is violated in trade models that feature heterogeneous firms and selection into exporting, but do not assume a Pareto-distributed productivity. [Helpman, Melitz, and Rubinstein \(2008\)](#) have further shown that omitting the effect of selection on the partial trade elasticity leads to biased gravity-based estimates of the elasticity. In light of these critiques, our structural method specifically takes into account the effect of selection on the partial trade elasticity and uses disaggregated trade data to back out the underlying distribution of export sales.

**Outline:** The rest of the paper is organized as follows. [Section 2](#) establishes a set of stylized facts about the properties of log-sales distributions across markets. [Section 3](#) constructs the Double Exponentially Modified Gaussian distribution and characterizes its properties. [Section 4](#) fits theoretical distributions to empirical export sales distributions and evaluates goodness of fit. [Section 5](#) demonstrates how the trade elasticity depends on distributional assumptions and defines a theory-based strategy for estimating the trade elasticity using micro-level export data. [Section 6](#) quantifies trade elasticities, documents the sample truncation bias in the estimates of trade elasticities, and explores implications of the sample truncation bias for measuring the welfare gains from trade. [Section 7](#) concludes. Proofs to all propositions are included in [Appendix A](#), and [Appendix B](#) contains a full description of the heterogeneous-firm trade model that we employ. [Appendix D](#) shows that our results hold for an alternative export sales data set; shows that our results are robust to sample selection, and, finally, shows that our results are robust to industry heterogeneity.

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<sup>6</sup>[Head and Mayer \(2014\)](#) provide a comprehensive summary of the corresponding literature, review various techniques for estimating the gravity equation, and discuss empirical challenges in using the reduced form approaches to estimate trade elasticities.

## 2 Empirical Facts

In this section we present new stylized facts that describe log-sales distributions across export destinations and discuss how these facts present a puzzle for standard distributional assumptions made in trade models.

The data come from the Brazilian customs declarations collected by SECEX (*Secretaria de Comercio Exterior*).<sup>7</sup> The data cover the period between 1990 and 2001, and include the value of export sales at the firm-product-destination-year level. A product is defined at a six-digit Harmonized Tariff System (HS) level. We focus on exports in manufacturing products.<sup>8</sup> To explore properties of the distribution of export sales across destinations and years, we aggregate the data to the firm-destination-year level and focus on destination-year observations where at least 100 firms export.<sup>9</sup> We define an observation to be an entire distribution of log-sales for a given destination in a given year.<sup>10</sup> The final sample consists of 847 destination-year distributions of log-sales.

Table 1 summarizes properties of log-sales distributions across destination-year observations. Each row presents a statistic and, because there is variation in these statistics across destination-year observations, each column reports a statistic’s average value, median value, standard deviation, minimum value, and maximum value.

**Fact 1** *Across destinations, export sales distributions are highly asymmetric.*

To describe the symmetry of log-sales distributions, we consider three different measures of skewness. The first is the standardized third moment measure of skewness. The second is nonparametric skew, which is defined as the difference between the mean and the median of a distribution divided by its standard deviation. The third is Kelly skewness defined as

$$\text{Kelly skewness} = \frac{(P90 - P50) - (P50 - P10)}{P90 - P10}, \quad (1)$$

where  $P10$ ,  $P50$ , and  $P90$  are the 10th, the 50th and the 90th percentiles of a distribution.<sup>11</sup>

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<sup>7</sup>See Molinaz and Muendler (2013) for a detailed description of the data set. These data have also been recently used by Flach (2016) and Flach and Janeba (Forthcoming).

<sup>8</sup>Manufacturing HS codes lie in the range between 10.00.00 and 97.00.00. In an average year exports in manufacturing products account for 90.82% of total exports.

<sup>9</sup>To be consistent with the literature, we make two decisions on how to use the data. First, we follow the vast majority of research on measuring theoretical trade elasticities by aggregating the data to destination-year, as opposed to industry-destination-year (see Head et al. (2014), Bas et al. (2015), Nigai (2017)). Second, we follow Fernandes, Klenow, Meleshchuk, Pierola, and Rodríguez-Clare (2015) in requiring at least 100 firms be present within a destination-year observation.

<sup>10</sup>In Appendix D, we consider an alternative definition of an observation that controls for the industrial composition of sales within destinations.

<sup>11</sup>In recent research on the asymmetry of earnings growth over the business cycle using administrative data

Table 1 shows that the majority of log-sales distributions are asymmetric. The average of each skewness measure across destination-year observations is positive and the averages are statistically different from zero with a maximum p-value of 0.0003 across measures. Among the 847 destination-year observations, 54% have positive skewness, 71% have positive nonparametric skew, and 75% have positive Kelly skewness.

We formally confirm the asymmetry in log-sales distributions through a standard test of Normality, as described in D’Agostino et al. (1990). Based on skewness alone, the test rejects normality in 31% of destination-year observations at the 10-percent significance level, 24% of observations at the 5-percent significance level, and 16% of observations at the 1-percent significance level. Based on both skewness and kurtosis, the test rejects normality in 42% of observations at the 10-percent significance level, 32% of observations at the 5-percent significance level, and 20% of observations at the 1-percent significance level.

**Fact 2** *Log-sales distributions exhibit a high degree of variation in the fatness of right and left tails.*

We focus on two measures to characterize the tail properties of log-sales distributions across destination-year observations. The first measure is kurtosis, which is the fourth standardized moment of a distribution. Kurtosis measures how much mass is located in the tails of a distribution relative to the mean. The kurtosis of a Normal distribution is constant and equals 3. A leptokurtic distribution has higher kurtosis than a Normal distribution and therefore exhibits fatter tails than a Normal. As can be seen from Panel A in Table 1, the average kurtosis across destination-year observations in the data is 3.17. Therefore, on average, the log-sales distributions are more fat-tailed than a Normal.

Similar findings hold for a percentile based measure of kurtosis defined as

$$\text{Percentile coefficient of kurtosis} = \frac{(P75 - P25)/2}{P90 - P10},$$

where  $P25$  and  $P75$  are the 25th and 75th percentiles of a distribution. For a Normal distribution the percentile coefficient of kurtosis is equal to 0.26. A smaller value of the coefficient corresponds to a distribution that is more kurtotic than a Normal. As can be seen from Panel B of Table 1, log-sales distributions exhibit substantial variation in kurtosis around the sample mean of 0.26 with a majority of observations being more kurtotic than a Normal.

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from the Social Security Administration, Guvenen, Ozkan, and Song (2014) use Kelly skewness to avoid the sensitivity of standardized moments to extreme values. Given that our data set contains fewer observations, we utilize Kelly skewness for robustness - to better ensure that our results are not generated by a small number of extreme value observations.

While kurtosis is informative about the overall fatness across a distribution’s tails (relative to a Normal distribution), it does not provide any information about how fat tails are relative to each other. In order to characterize fatness in the left tail relative to fatness in the right tail, we follow [Gabaix and Ibragimov \(2011\)](#) in estimating the right and left tail index parameters for each log-sales distribution across destination-years. Tail index parameters are estimated as the coefficient  $\beta$  from the following regression:

$$\log(\text{Rank}_i - 0.5) = \alpha + \beta \log(\text{Sales}_i) + \epsilon_i,$$

where  $i$  indexes firms within an export destination,  $\text{Sales}_i$  is firm  $i$ ’s export sales, and  $\text{Rank}_i$  is firm  $i$ ’s sales rank out of all firms exporting to a particular destination. We run this regression on a sample of firms in the top or bottom 5%, 10% and 15% of a distribution for each destination-year observation. The smaller is the estimate of the coefficient, the fatter is the corresponding tail of the distribution.<sup>12</sup>

Results are summarized in Panel C of [Table 1](#), which report information about the absolute value of the coefficient  $\beta$  as estimated across destination-year observations. These results indicate that the log-sales distributions exhibit substantial fatness in both the left and right tails. Depending on the sample, the average value of the tail index coefficient varies between 1.01 and 1.42. Notably, the left tail index exhibits more fatness than the right tail index. For example, the sample average of the left tail index for the bottom 15% of firms is 1.01, while for the top 15% the average is 1.08.

Furthermore, we find that both tails are simultaneously fat in a majority of cases. [Figure 1](#) provides a scatter plot of the tail index estimates for the top and bottom 5% of firms in a distribution. Each dot in the Figure corresponds to an estimate of the right tail index (x-axis) and the left tail index (y-axis) for a given destination-year observation. Observe that both tail indexes have values below 2 for a majority of distributions. Our finding that the right tail of the log-sales distribution tends to be fat is consistent with previous research (see [Axtell \(2001\)](#), [di Giovanni and Levchenko \(2013\)](#)). However, our finding that the *left* tail of log-sales distributions exhibits substantial fatness is, to the best of the authors’ knowledge, new to the trade literature.

**Role of Small Firms:** The novel properties of the log-sales export distributions which we document are primarily driven by the presence of small exporters across destinations. The existence of small firms in the Brazilian export data is a special feature of the data set,

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<sup>12</sup> When the regression is ran for the top 5%, 10% or 15% of firms, the largest firm is ranked 1, the second largest is ranked 2, etc. When the regression is ran for the bottom 5%, 10% or 15% of firms, the smallest firm is ranked 1, the second smallest is ranked 2, etc.

insofar as Brazilian customs keep a careful record of all export transactions, including the smallest exporters. Panel D of [Table 1](#) reports that the size of an average exporter is about 62 thousand times larger than the size of the smallest exporter. The abundance of small exporters across destinations is the main driver of the negative skewness and left-tail fatness of log-export sales distributions that we observe in the data.

To clearly demonstrate the role of small firms in shaping the novel features of the log-export sales distributions, we create an artificial truncated data set. We take the original log-sales data and drop all firm-destination-year observations with a value of exports below \$5,000. [Table 2](#) replicates the results of [Table 1](#) using truncated data. Observe that even a modest truncation point significantly reduces the gap between the size of the smallest and an average firm in a distribution. Panel D of [Table 2](#) reports that, in the truncated sample, the average firm is only about 160 times larger than the smallest firm. As a result, when a sample omits the smallest exporters, the log-export sales distributions become overwhelmingly positively skewed with thinner left tails. The skewness of an average distribution increases from 0.03 to 0.59. Further, the tail parameter estimate of the sales of bottom 5% of firms increase from 1.21 to 8.61. Notice, that the values of right-tail parameters are not significantly effected by the sample truncation.<sup>13</sup>

**Relationship to Parametric Distributions:** Facts 1 and 2, above, contradict key properties of the standard theoretical distributions employed by new trade models. In particular, the Normal and an Exponential distributions (commonly referred to as the log Normal and Pareto distributions when considering levels of exports instead of log-exports) will not fit the empirical log-export sales distributions across several dimensions. First, the Normal distribution is symmetric, and therefore all considered skewness measures equal zero for a Normal. Second, the Exponential distribution has skewness of 2, nonparametric skewness of 0.31 and Kelly skewness of 0.47. Across each of the three measures, the Exponential distribution’s skewness does not depend on the distribution’s parameter values. As shown in [Table 1](#), the majority of log-sales export distributions however are not symmetric, do not share the same level of skewness, and are less skewed than an Exponential distribution. Therefore, according to all three measures of skewness, neither the Normal nor the Exponential distributions can characterize the export sales data well. Furthermore, excess kurtosis of log-export sales distributions immediately imply that a Normal distribution poorly characterizes the log-sales distributions. The log-sales distributions would also be poorly approximated by an Exponential due to the presence of a fat left tail.

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<sup>13</sup>We have also computed results for thresholds of \$50,000, \$100,000, and \$250,000. We find that as the value of the truncation point increases, the distributions become more positively skewed and exhibit thinner left tails. These results are available upon request.

### 3 The Double Exponentially Modified Gaussian Distribution

The Double Exponentially Modified Gaussian (Double EMG) distribution is defined as a convolution of a Normal distribution and a Double Exponential distribution. As a result, one of the key properties of the distribution is its flexible behavior in the right and left tails. Hence, the Double EMG distribution is well suited to generate empirical regularities in the log-sales export data as documented in [Section 2](#). Furthermore, the distribution arises naturally in models that feature both Double Pareto and log-Normal shocks that affect firms' profit. In [Section 3.1](#) we derive several key properties characterizing the distribution including its behavior in the right and left tails.

#### 3.1 Characterization of the Double EMG

Consider a random variable  $z$  defined as  $z = x + y$ , where  $x$  and  $y$  are two independent random variables. Assume  $x \sim \mathcal{N}(\mu, \sigma^2)$  is Normally distributed, and  $y \sim \mathcal{DE}(\lambda_L, \lambda_R)$ , where  $\mathcal{DE}$  denotes the Double Exponential distribution.<sup>14</sup> In this case, random variable  $z$  is a convolution of a Normal and a Double Exponential random variables and is said to follow a Double Exponentially Modified Gaussian (Double EMG) distribution with parameters  $(\mu, \sigma, \lambda_L, \lambda_R)$ . [Proposition 1](#), below, formally characterizes the Double EMG distribution with its cumulative distribution function. [Proposition 2](#) further characterizes the the Double EMG distribution's limiting properties.<sup>15</sup>

**Proposition 1** *Let  $x$  and  $y$  be independent random variables such that  $x \sim \mathcal{N}(\mu, \sigma^2)$ ,  $y \sim \mathcal{DE}(\lambda_L, \lambda_R)$  and parameters satisfy  $\mu \in \mathbb{R}$ ,  $\sigma > 0$ , and  $\lambda_L, \lambda_R > 0$ . The random variable  $z \equiv x + y$  has the cumulative distribution function  $G : \mathbb{R} \rightarrow [0, 1]$  given by:*

$$G(z) = \Phi\left(\frac{z - \mu}{\sigma}\right) - \frac{\lambda_L}{\lambda_L + \lambda_R} e^{-\lambda_R(z - \mu) + \frac{\sigma^2}{2} \lambda_R^2} \Phi\left(\frac{z - \mu}{\sigma} - \lambda_R \sigma\right) + \frac{\lambda_R}{\lambda_L + \lambda_R} e^{\lambda_L(z - \mu) + \frac{\sigma^2}{2} \lambda_L^2} \Phi\left(-\frac{z - \mu}{\sigma} - \lambda_L \sigma\right).$$

**Proposition 2** (*Limiting Results*) *Let  $z$  be a Double Exponentially Modified Gaussian distributed random variable with parameters  $(\mu, \sigma, \lambda_L, \lambda_R)$ . The random variable  $z$  is (i) an*

<sup>14</sup>The Double Exponential distribution is also referred to as an Asymmetric Laplace distribution. The cumulative distribution function is given by  $G_{\mathcal{DE}}(y) = \frac{\lambda_R}{\lambda_L + \lambda_R} e^{\lambda_L y}$  if  $y < 0$ , and  $G_{\mathcal{DE}}(y) = \frac{\lambda_L}{\lambda_L + \lambda_R} - \frac{\lambda_L}{\lambda_L + \lambda_R} (1 - e^{-\lambda_R y})$  if  $y \geq 0$ .

<sup>15</sup>The proofs to all propositions are included in [Appendix A](#).

Exponentially Modified Gaussian distributed random variable as  $\lambda_L$  goes to infinity, (ii) an Exponentially Modified Gaussian distributed random variable with a Normal right tail and Exponential left tail as  $\lambda_R$  goes to infinity, (iii) a Double Exponentially distributed random variable as  $\sigma$  goes to zero, where if  $\mu \neq 0$  then this limiting distribution is a shifted Double Exponential distribution, and (iv) an Exponentially distributed random variable as  $\sigma$  goes to zero and  $\lambda_L$  goes to infinity.

Recall that as the variance of a distribution becomes arbitrarily small, the corresponding distribution has a point mass. [Proposition 2](#), therefore, implies that the Double EMG distribution generalizes both the Normal and the Exponential distributions. When the Double Exponential component has zero variance (i.e.  $(\lambda_L^{-1} + \lambda_R^{-1}) \rightarrow 0$ ), the Double EMG distribution is transformed into a Normal distribution. Similarly, when the Normal component has zero variance together with  $\lambda_L \rightarrow +\infty$ , the Double EMG distribution converged to Exponential.

[Proposition 3](#) below shows that, as a consequence of being a convolution of a Normal and a Double Exponential random variable, the Double EMG distribution can generate both positive and negative skewness as well as fatness in both the left and right tails of the distribution.

**Proposition 3** *If  $z$  is a Double Exponentially Modified Gaussian distributed random variable on  $(-\infty, +\infty)$  then the skewness of  $z$  is given by*

$$skew(z) = 2 \left( \frac{1}{\sigma^3 \lambda_R^3} - \frac{1}{\sigma^3 \lambda_L^3} \right) \left( 1 + \frac{1}{\sigma^2 \lambda_R^2} + \frac{1}{\sigma^2 \lambda_L^2} \right)^{-\frac{3}{2}}.$$

Furthermore, the sign of  $skew(z)$  is determined by the relative size of the tail parameters: (i)  $skew(z) > 0$  if  $\lambda_L > \lambda_R$ , (ii)  $skew(z) = 0$  if  $\lambda_L = \lambda_R$ , and (iii)  $skew(z) < 0$  if  $\lambda_L < \lambda_R$ .

The skewness of the Double EMG distribution exhibits two stark properties. First, the distribution has a potential to generate both positive and negative skewness in the range between -2 and 2. Notably, the sign of the skewness depends on the relative fatness of the right and left tails of the distribution as measured by parameters  $\lambda_R$  and  $\lambda_L$ . Second, the distribution can be symmetric (when  $\lambda_L = \lambda_R$ ), yet exhibit substantial deviations from a Normal in the tails when the values for  $\lambda_R$  and  $\lambda_L$  are small.

Figure 2 provides an example of two probability density functions for two distributions with zero mean and the unit variance. The solid line depicts a probability density function for a symmetric Double EMG distribution (although the tails need not be symmetric), and the dashed line depicts a probability density function for a Normal distribution. Notice

that relative to a Normal, the Double EMG, while preserving the unimodal property of the distribution, has more mass in the right and left tails. This is a key distinction between the two distributions which helps the Double EMG to flexibly match features of log-export sales distributions.

Hence, the Double EMG is the most flexible distribution among those considered in the trade literature and has the potential to match all of the new stylized facts documented in [Section 2](#). In the next section we describe our strategy for fitting the Double EMG distribution to the data and compare the distribution’s fit to that of the Normal and Exponential.

## 4 Fitting to Empirical Distributions

In this section we describe our strategy for estimating distributional parameters using export sales data from Brazil. Then, equipped with estimated parameters for each destination-year log-sales distribution, we compare the fit of the Double Exponentially Modified Gaussian, Normal and Exponential distributions. We show that the Double Exponentially Modified Gaussian distribution has a superior fit to the data when compared to the Normal and Exponential distributions.

### 4.1 Parameter Estimation

We choose distribution parameters so that the percentiles of the theoretical log-sales distribution match the percentiles of the empirical log-sales distribution. Specifically, we recover parameters of a theoretical distribution from non-linear quantile regressions that we implement using a generalized method of moments procedure. Our procedure is a generalization of [Head, Mayer, and Thoenig \(2014\)](#), who use quantile regressions to estimate parameters of the Pareto and a log-Normal distributions, both of which have linear quantile functions and therefore parameters can be estimated using linear regression. In contrast, the Double EMG distribution does not admit a linear quantile function (as can be inferred from [Proposition 1](#)) and therefore we estimate the parameters of the Double EMG distribution using a Generalized Method of Moments (GMM) procedure. For the Normal and Exponential distributions, our procedure can recover the parameter estimates implied by linear regression.

Denote by  $n_q$  the number of sales quantiles. Let  $(\log r)_i^d$  denote the  $i$ -th quantile of the empirical log-sales distribution and  $F_i^d$  denote the corresponding value of the empirical CDF at the  $i$ -th quantile.<sup>16</sup> By comparison, let  $(\log r)_i(\Theta)$  denote the  $i$ -th quantile of the theo-

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<sup>16</sup>Following [Head, Mayer, and Thoenig \(2014\)](#), we define the empirical CDF over log-sales as  $F_i^d = (i - 0.3)/(n_q + 0.4)$ .

retical cumulative distribution function with parameters  $\Theta$  and let  $F[(\log r)_i|\Theta]$  denote the corresponding value of the theoretical cumulative distribution function at the  $i$ -th quantile.

For an arbitrary distribution over log-sales, we can recover the theoretical quantiles by inverting the theoretical cumulative distribution function. Generally, the inverse can be computed numerically for each value of the empirical cumulative distribution function,  $\{F_i^d\}_{i=1}^{n_q}$ , by using a root-finding procedure to find the value of  $\log r$  such that  $F_i^d = F(\log r|\Theta)$  up to the desired tolerance of error.

For the Double EMG distribution, the parameter vector is  $\Theta = (\mu, \sigma, \lambda_L, \lambda_R)$  such that  $\log r \sim F(\log r|\mu, \sigma, \lambda_L, \lambda_R)$ . However, the inverse of the Double EMG distribution does not admit a closed form expression. Therefore, the inverse of the cumulative distribution function must be computed numerically.

By a change of variables, log-sales are Normally distributed if sales are log-Normally distributed. Similarly, log-sales are Exponentially distributed if sales are distributed according to a Pareto. Both the Normal and Exponential distributions do, in fact, admit closed form expressions for the inverted cumulative distribution functions, of the forms:

$$\begin{aligned} (\log r)_i^N(\Theta^N) &= \mu^N + \sigma^N \Phi^{-1}(F_i^d) \\ (\log r)_i^E(\Theta^E) &= \log(r) + (1/\lambda^E) \log(1 - F_i^d), \end{aligned}$$

where  $\Phi(\cdot)$  is the CDF of a standard normal, and  $\Theta^N = (\mu^N, \sigma^N)$  and  $\Theta^E = (\log(r), \lambda^E)$  denote the parameter vectors for the Normal and Exponential distributions, respectively.

Finally, for a given theoretical distribution  $F(\cdot|\Theta)$ , we choose parameters  $\Theta$  that minimize the sum of the squared errors between empirical and theoretical quantiles:

$$\min_{\Theta} \sum_{i=1}^{n_q} [(\log r)_i^d - (\log r)_i(\Theta)]^2. \quad (2)$$

In estimation, we use the 1st through 99th percentiles of the empirical CDF to estimate parameters. In practice, this choice eases computational burden compared to using each data point, without significantly changing the parameter estimates we recover. Furthermore, note that choosing parameters to minimize the sum of squared residuals is equivalent to [Head et al.'s \(2014\)](#) method of recovering parameters from quantile regressions. Our procedure recovers approximately the same parameter estimates for the Normal and Exponential distributions as those authors' method.

## 4.2 Double EMG Fit to Empirical Distributions

Having estimated distribution parameters, we now evaluate the fit of each distribution to the log-sales distributions across destination-years.

**Result 1** *According to multiple goodness of fit statistics, the Double Exponentially Modified Gaussian distribution fits empirical log export sales distributions better than the Normal and Exponential distributions.*

We first argue that the Double EMG distribution fits the data better than either the Normal or Exponential distributions by examining fitted distribution functions versus their empirical counterparts. We observe that the Double EMG distribution deviates from the data less than the Normal distribution, especially at the lower and upper percentiles. Panel A of [Figure 3](#) compares the left tail across the empirical, Double EMG and Normal distributions. We observe that the Double EMG distribution provides a superior fit than the Normal in the left tail. Panel B of [Figure 3](#) compares the right tail across distributions. We observe that the Double EMG distribution barely deviates from the empirical distribution up to the 99th percentile. In both tails, the Normal distribution is too thin relative to the data.

To better formalize the suggestive evidence we have put forth thus far, we consider three primary measures of the goodness of fit. [Figure 4](#) presents goodness of fit statistics for each of the distributions under consideration. Specifically, the [Figure 4](#) presents scatter plots of goodness of fit measures from the Exponential distribution (top row) or the Normal distribution (middle row), plotted against goodness of fit measures for the Double EMG distribution.

The first measure is the sum of squared errors (reported in the first column), which is given by the objective criterion from the estimation procedure given in equation (2) when evaluated at the error-minimizing parameters. Panel A and Panel D of [Figure 4](#) show that errors are larger for the Normal and Exponential distributions than the Double EMG distribution. This is unsurprising, since the Double EMG distribution nests both the Normal and Exponential distributions as limiting cases (see [Proposition 2](#)). More interesting is the fact that both Panels A and D show that the errors are much larger for the Normal and Exponential distributions. However, the magnitude of the difference in errors is smaller for the Normal than the Exponential distribution.

The second measure is the Mean Absolute Error, which is given by:

$$MAE(\Theta) \equiv \frac{1}{n_q} \sum_{i=1}^{n_q} \left| (\log r)_i^d - (\log r)_i(\Theta) \right|.$$

The Mean Absolute Error measures the average deviation of the theoretical distribution from the empirical in either direction, but unlike the sum of squared errors does not more harshly penalize infrequent but large deviations. The second column (Panels B and E) of [Figure 4](#) shows that errors are larger for the Normal and Exponential distributions than the EMG distribution. Therefore, the Mean Absolute Error reinforces that the Double EMG distribution has a superior fit, and that the difference in errors across the three distributions are not generated by a small number of large deviations from empirical observations.

The third measure is the Anderson-Darling statistic, which is given by:

$$AD(\Theta) \equiv n_q \sum_{i=1}^{n_q} \frac{[F_i^d - F((\log r)_i|\Theta)]^2}{F[(\log r)_i|\Theta][1 - F((\log r)_i|\Theta)]} f[(\log r)_i|\Theta],$$

where  $f[(\log r)_i|\Theta]$  is the theoretical probability density function.<sup>17</sup> Compared to our two other goodness of fit measures, the Anderson-Darling statistic places greater weight on observations in the tails of the distributions. To see this, consider the denominator within the integral. As  $F(\log r|\Theta)$  approaches one or zero,  $[F(\log r|\Theta)(1 - F(\log r|\Theta))]^{-1}$  approaches infinity. Therefore, the denominator is smallest for values of  $\log r$  for which  $F(\log r|\Theta)$  is interior to  $[0, 1]$ . The third column of [Figure 4](#) shows that the Anderson-Darling statistics are larger for the Normal and Exponential distributions than the Double EMG distribution. Therefore, the deviations of the Normal and Exponential distributions from the data can be, at least partially, attributed to a failure to match tail observations. This is particularly true for the Exponential distribution, which by construction cannot match the left tail of the sales distributions.

Taken together, these three measures show that the Double EMG distribution consistently fits the log-sales distributions better across destination-year observations, and that the Normal and Exponential distributions consistently fit the data worse in the tails of the distribution.<sup>18</sup>

## 5 Theoretical Trade Elasticity

In this section, we employ the workhorse heterogeneous-firm trade model, along the lines of [Melitz \(2003\)](#) and [Chaney \(2008\)](#), to illustrate a relationship between export sales distributions and the partial trade elasticity. We demonstrate that variation in the partial trade

<sup>17</sup>We compute this the density function as a numerical approximation to the derivative of the cumulative distribution function:  $f(\log r|\Theta) \equiv (F(\log r + \Delta|\Theta) - F(\log r - \Delta|\Theta))/2\Delta$ . The constant  $\Delta > 0$  is chosen as a tenth of the maximum distance between successive empirical quantiles.

<sup>18</sup>Appendix C further demonstrates that the Double EMG distribution provides a consistently better fit to the log-sales distributions compared to the Generalized Normal distribution.

elasticity across destinations arises from the variation in the extensive margin of firm entry and exit. We further show that the extensive margin elasticity can be identified from properties of empirical export sales distributions and, finally, develop an estimation approach for quantifying the magnitude of the extensive margin elasticity.

## 5.1 Economic Environment

There are  $N$  countries. We will denote by  $i$  the origin country and by  $j$  a destination country. Each country  $j$  is populated by  $L_j$  identical consumers with preferences given by a constant elasticity of substitution utility function given by

$$U_j = \left( \sum_{i=1}^N \int_{\omega \in \Omega_{ij}} (e^{\theta_{ij}(\omega)})^{\frac{1}{\epsilon}} c_{ij}(\omega)^{\frac{\epsilon-1}{\epsilon}} d\omega \right)^{\frac{\epsilon}{\epsilon-1}},$$

where  $\Omega_{ij}$  is the set of varieties consumed in country  $j$  originating from country  $i$ ,  $c_{ij}(\omega)$  is the consumption of variety  $\omega \in \Omega_{ij}$ ,  $\epsilon$  is the elasticity of substitution, and  $\theta_{ij}(\omega)$  is the demand parameter for variety  $\omega \in \Omega_{ij}$ .<sup>19</sup>

Each consumer owns a share of domestic firms and is endowed with one unit of labor that is inelastically supplied to the market. Cost minimization yields optimal demand for variety  $\omega \in \Omega_{ij}$  given by

$$c_{ij}(\omega) = e^{\theta_{ij}(\omega)} p_{ij}(\omega)^{-\epsilon} Y_j P_j^{\epsilon-1}, \quad (3)$$

where  $p_{ij}(\omega)$  is the price of variety  $\omega \in \Omega_{ij}$ ,  $Y_j$  is income in country  $j$  and  $P_j$  is the aggregate price index in country  $j$  given by  $P_j^{1-\epsilon} = \sum_{i=1}^N \int_{\omega \in \Omega_{ij}} e^{\theta_{ij}(\omega)} p_{ij}(\omega)^{1-\epsilon} d\omega$ .

## 5.2 Supply

As in [Chaney \(2008\)](#), each country is endowed with the exogenous mass  $J_i$  of prospective entrants. Upon entry, a firm is endowed with an idiosyncratic labor productivity level  $\varphi$  and a destination-specific demand parameter  $\theta_j$ . Productivity and destination-specific demand parameters are drawn from separate independent distributions. Firms face fixed  $f_{ij}$  and variable  $\tau_{ij}$  costs of selling from country  $i$  to country  $j$  denominated in terms of units of labor.

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<sup>19</sup>[Bernard, Redding, and Schott \(2010\)](#) interpret  $\theta_{ij}(\omega)$  as variations in consumer tastes or relative demand across different varieties. In [Timoshenko \(2015\)](#)  $\theta_{ij}(\omega)$  represents product demand that firms need to learn over time through market participation.

Once productivity and demand are realized, firms compete in a monopolistically competitive environment. Firms maximize profits subject to the consumer demand (14) yielding the optimal price given by

$$p_{ij}(\varphi) = \frac{\epsilon}{\epsilon - 1} \frac{\tau_{ij} w_i}{\varphi},$$

where  $w_i$  is the wage in country  $i$ . The corresponding firm's optimal revenues and profits are given by

$$r_{ij}(\theta_{ij}, \varphi) = \left( \frac{\epsilon - 1}{\epsilon} \right)^{\epsilon - 1} (\tau_{ij} w_i)^{1 - \epsilon} Y_j P_j^{\epsilon - 1} e^{\theta_{ij}} \varphi^{\epsilon - 1}, \quad (4)$$

$$\pi_{ij}(\theta_{ij}, \varphi) = \frac{r_{ij}(\theta_{ij}, \varphi)}{\epsilon} - w_i f_{ij}. \quad (5)$$

### 5.3 Profitability and Sales

Notice from equations (4) and (5) that a firm's profitability in market  $j$  depends on both a firm's productivity  $\varphi$  and a demand parameter  $\theta_j$  in a multiplicative way. Hence a low productivity firm can generate positive profits if the demand for its product is high, and vice versa. Thus, selection into a market occurs based on a firm's profitability, and not productivity or demand alone. Denote by  $z_{ij}$  the firm's payoff relevant state variable given by

$$z_{ij} = \theta_{ij} + \log(\varphi^{\epsilon - 1}). \quad (6)$$

We will refer to  $z_{ij}$  as a firm's *profitability* in market  $j$ .<sup>20</sup> Given  $z_{ij}$ , we can rewrite the firm's optimal revenue and profit as a function of profitability  $z_{ij}$  as

$$r_{ij}(z_{ij}) = \left( \frac{\epsilon - 1}{\epsilon} \right)^{\epsilon - 1} (\tau_{ij} w_i)^{1 - \epsilon} Y_j P_j^{\epsilon - 1} e^{z_{ij}}. \quad (7)$$

Profitability  $z_{ij}$  is a generalized representation of firm-level heterogeneity in the context of the new trade theories. For example, in a canonical Melitz (2003) environment, the underlying source of heterogeneity in profitability arises solely from heterogeneity in labor productivity across firms,  $\varphi$ . Chaney (2008) further assumes that firm-level labor productivity  $\varphi$  is drawn from a Pareto distribution with shape parameter  $\xi$ . In this case,  $e^{z_{ij}}$

<sup>20</sup>Following Foster, Haltiwanger, and Syverson (2008) and Bernard, Redding, and Schott (2010), profitability refers to firm-level shocks that may be the outcome of not only productivity differences but also differences in product demand.

equals  $\varphi^{\epsilon-1}$  and, by a change of variables,  $z_{ij}$  follows an Exponential distribution with shape parameter  $\lambda = \xi/(\epsilon - 1)$ .

In contrast to Chaney (2008), more recent work by Bas, Mayer, and Thoenig (2015) and Fernandes, Klenow, Meleshchuk, Pierola, and Rodríguez-Clare (2015) assumes that the underlying labor productivity  $\varphi$  is drawn from a log-Normal distribution,  $\log \mathcal{N}(m, v^2)$ . In this case,  $e^{z_{ij}}$  equals  $\varphi^{\epsilon-1}$ , and  $z_{ij}$  follows a Normal distribution,  $\mathcal{N}(\mu, \sigma^2)$  where  $\mu = m(\epsilon - 1)$  and  $\sigma^2 = v^2(\epsilon - 1)^2$ .

Generalizing both sets of distributional assumptions, our framework assumes that there are two separate sources of heterogeneity in firm-level profitability. Heterogeneity arises from firm-level labor productivity  $\varphi$  drawn from a Double Pareto distribution with a shape parameter  $\xi$ , and firm-level product demand  $e_{ij}^\theta$ , where  $\theta_{ij}$  is drawn from a Normal distribution  $\mathcal{N}(m, v^2)$ , so that  $e^{z_{ij}}$  equals  $e^{\theta_{ij}}\varphi^{\epsilon-1}$ .<sup>21</sup> In this case, a firm's profitability draw,  $z_{ij} = \theta_{ij} + \log(\varphi^{\epsilon-1})$ , is the sum of a Normal and a Double Exponential random variable. Hence,  $z_{ij}$  is a Double EMG distributed random variable with parameters  $(\mu, \sigma, \lambda_L, \lambda_R)$ , where  $\mu = m$ ,  $\sigma^2 = v^2(\epsilon - 1)^2$ ,  $\lambda_L = \xi_L/(\epsilon - 1)$  and  $\lambda_R = \xi_R/(\epsilon - 1)$ .

In the context of the aforementioned firm-level learning literature, equation (7) is a general representation of sales from country  $i$ 's firms to country  $j$ . While variation in profitability across firms may arise from differences in firm-specific labor productivity, destination-specific demand shocks or some combination of both, equation (7) shows that only the cumulative effect, summarized by the profitability draw  $z_{ij}$ , determines the level of sales.

## 5.4 Aggregation

The aggregate trade flow from country  $i$  to country  $j$  is defined as

$$X_{ij} = M_{ij} \int_{z_{ij}^*}^{+\infty} r_{ij}(z) \frac{g_{ij}(z)}{1 - G_{ij}(z)} dz, \quad (8)$$

where  $M_{ij}$  is the mass of firms exporting from country  $i$  to  $j$ , and  $z_{ij}^*$  is the profitability entry threshold determined by the zero-profit condition. The partial elasticity of trade with respect to variable trade costs is defined as the percent-change in the aggregate trade flows between  $i$  and  $j$  as a result of a percent-change in variable trade costs  $\tau_{ij}$  and can be expressed as

$$\frac{\partial \log X_{ij}}{\partial \log \tau_{ij}} = \underbrace{(1 - \epsilon)}_{\text{level of the partial trade elasticity}} \left( \underbrace{1}_{\text{intensive margin contribution}} + \underbrace{\gamma_{ij}}_{\text{extensive margin contribution}} \right), \quad (9)$$

<sup>21</sup>In order to be consistent with standard trade models, assume that there is no idiosyncratic or aggregate uncertainty after firms enter the market, firms always observe their product demand, and that the product demand does not vary over time (see Appendix B).

where  $\gamma_{ij}$  is given by

$$\gamma_{ij} \equiv \frac{g_{ij}(z_{ij}^*)}{(1 - G_{ij}(z_{ij}^*))} \cdot \frac{e^{z_{ij}^*}}{E_{ij}(e^z | z > z_{ij}^*)}. \quad (10)$$

Functions  $g_{ij}(z)$  and  $G_{ij}(z)$  denote the probability density function and cumulative distribution function over firms' profitability respectively;  $E_{ij}(\cdot | z > z_{ij}^*)$  is a conditional expectation over profitability.<sup>22</sup>

A conventional way to write equation (9) is  $\partial \log X_{ij} / \partial \log \tau_{ij} = (1 - \epsilon) + (1 - \epsilon)\gamma_{ij}$ , where  $(1 - \epsilon)$  is the intensive margin, and  $(1 - \epsilon)\gamma_{ij}$  is the extensive margin of the partial trade elasticity.<sup>23</sup> The advantage of the representation in equation (9) is that it highlights the distinct roles for the elasticity of substitution ( $\epsilon$ ) and the parameter governing the extensive margin elasticity ( $\gamma_{ij}$ ) in determining the partial trade elasticity.<sup>24</sup> As can be seen from equation (9),  $\epsilon$  governs the overall *level* of the trade elasticity, the contribution of the *intensive margin* to that level is always unity, and the contribution of the *extensive margin* is governed by  $\gamma_{ij}$ . Hence, every dollar of new trade can be decomposed into an intensive and extensive margin adjustment in the proportion of 1 to  $\gamma_{ij}$ , which is notably independent from  $\epsilon$ .

Equations (9) and (10) illustrate the important role that micro-level firm heterogeneity plays in the aggregate measures of partial trade elasticity. From equation (9), the main source of variation in the partial trade elasticity across origin-destination country pairs arises from variation in the extensive margin elasticity,  $\gamma_{ij}$ .<sup>25</sup> In turn, equation (10) demonstrates that the extensive margin elasticity is solely determined by the shape of the log-sales distributions summarized by the probability density and the cumulative distribution functions,  $g_{ij}(\cdot)$  and  $G_{ij}(\cdot)$ , respectively, and the entry profitability threshold,  $z_{ij}^*$ . We describe the estimation method for  $\gamma_{ij}$  in the next subsection.<sup>26</sup>

<sup>22</sup>The partial trade elasticity is derived in [Appendix B](#).

<sup>23</sup>[Chaney \(2008\)](#) first suggested this decomposition in conjunction with a Pareto distribution. With Pareto distributed  $z_{ij}$ , equation (10) simplifies to  $\gamma_{ij} = \xi / (\epsilon - 1) - 1$  and  $\xi$  is the Pareto tail parameter. Substituting this expression for  $\gamma_{ij}$  yields [Chaney's \(2008\)](#) familiar formula for the partial trade elasticity:  $\partial \log X_{ij} / \partial \log \tau_{ij} = -\xi$ .

<sup>24</sup>[Melitz and Redding \(2015\)](#) provide a representation of the partial trade elasticity consistent with equation (9).

<sup>25</sup>Variation in the level of the partial trade elasticity can, in principle, arise from the elasticity of substitution being destination specific. Following the vast majority of the literature we abstract away from this generalization and leave it for future research.

<sup>26</sup>In our generalization, notice that the partial trade elasticity is origin-destination specific due to the profitability entry thresholds *and* the profitability distributions being origin-destination specific. This is in contrast to a more restrictive assumption of a constant partial trade elasticity in [Arkolakis et al.'s \(2012\)](#) framework. A constant partial trade elasticity requires the elasticity to be independent of the endogenous profitability entry threshold *and* the profitability distribution not be destination specific. As a consequence, the most common gravity estimation approach will uncover only a sample average of origin-destination specific partial trade elasticities, which in fact may vary due to origin-destination specific distributions.

## 5.5 Estimation Method

Equation (10) highlights that for a general distributional assumption, the extensive margin contribution to the partial elasticity of trade with respect to variable trade costs,  $\gamma_{ij}$ , is intimately connected to the size of a marginal exporter as captured by the profitability entry threshold,  $z_{ij}^*$ . A model-consistent estimation method therefore must rely on using information about the smallest exporters to identify the extensive margin elasticity,  $\gamma_{ij}$ .

To compute extensive margin elasticities in equation (10) we proceed by, first, estimating the origin-destination specific distributions of firm profitability,  $G_{ij}(\cdot)$  and, second, using estimated parameters of the distributions to recover the profitability entry thresholds,  $z_{ij}^*$ .

In the absence of selection into exporting, parameters of the distribution  $G_{ij}(\cdot)$  can be recovered from micro-data on log-sales distributions by applying the estimation procedure in Section 4.1. From equation (7), we can write log-sales,  $\log(r_{ij}(z_{ij}))$ , as

$$\log(r_{ij}(z_{ij})) = \log(C_{ij}) + z_{ij}, \quad (11)$$

where  $C_{ij} = \left(\frac{\epsilon-1}{\epsilon}\right)^{\epsilon-1} (\tau_{ij}w_i)^{1-\epsilon} Y_j P_j^{\epsilon-1}$ . In this case, equation (11) highlights a one-to-one mapping between the distribution of log-sales and the distribution of the underlying profitability shocks. The two distributions are equal up to a scale parameter ( $C_{ij}$ ). Hence, parameters of the firms' profitability distribution,  $G_{ij}(z)$ , can be recovered by fitting that distribution to the empirical distribution of log-sales.

However, this method for recovering  $G_{ij}(z)$  is not directly applicable to the Melitz (2003) model that features selection into exporting. With selection, equation (11) only holds when  $z_{ij} > z_{ij}^*$  or equivalently when  $\log(r_{ij}) > \log(r_{ij}^*)$ . Hence, the observed distribution of export sales follows a truncated profitability distribution given by  $[G_{ij}(\log(r)) - G_{ij}(\log(r_{ij}^*))]/[1 - G_{ij}(\log(r_{ij}^*))]$ . Therefore, to obtain model-consistent estimates of trade elasticities, we amend the estimation procedure developed in Section 4.1 to incorporate truncation into the estimation procedure. Specifically, we recover parameters of the distribution  $G_{ij}(\cdot)$  by fitting a truncated density of the firms' profitability distribution to the micro-data on log-sales distributions. To compute the truncated distribution, we take the truncation point,  $\log(r_{ij}^*)$ , as given by the value of the zeroth percentile of the corresponding log-export sales distribution. Using information about the size of the smallest exporter follows an estimation methodology developed by Bas, Mayer, and Thoenig (2015), which we further employ to recover profitability thresholds  $z_{ij}^*$ . Namely, given the estimated origin-destination specific distribution parameters we recover the threshold  $z_{ij}^*$  from the average-to-minimum ratio of a sales distri-

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This is also a key point in Melitz and Redding (2015).

bution.<sup>27</sup> From equation (7), we can express the theoretical average-to-minimum ratio as a function of  $z_{ij}^*$  alone:

$$\frac{E_{ij}(r_{ij}(z_{ij})|z_{ij} > z_{ij}^*)}{r_{ij}(z_{ij}^*)} = \frac{E_{ij}(e^{z_{ij}}|z_{ij} > z_{ij}^*)}{e^{z_{ij}^*}}. \quad (12)$$

Subsequently, we compute the value of  $z_{ij}^*$  for which expression (12) equals the empirical average-to-minimum ratio.<sup>28</sup>

Our approach slightly differs from Bas, Mayer, and Thoenig (2015) in that it does not require any knowledge of the elasticity of substitution when computing the profitability entry threshold  $z_{ij}^*$  or the corresponding extensive margin contribution to the partial trade elasticity,  $\gamma_{ij}$ . The main distinction is that our firm-level profitability construct consolidates various types of (productivity or demand) shocks and the elasticity of substitution into a single parameter,  $z_{ij}$ . As a result, we can use equation (11) to directly estimate parameters of the profitability distribution,  $G_{ij}(\cdot)$ , from log-export sales data, and then use equations (10) and (12) to compute  $z_{ij}^*$  and  $\gamma_{ij}$  using only the estimated distribution. The advantage of our approach lies in its ability to estimate the extensive margin of the partial trade elasticity without estimating the elasticity of substitution,  $\epsilon$ , which has its own challenges as extensively discussed in Bas, Mayer, and Thoenig (2015).<sup>29</sup>

## 6 Quantifying Trade Elasticities

In this section, we report the quantitative magnitudes of extensive margin elasticities and the resulting extent of variation in the partial trade elasticity across origin-destination country pairs. We find that the magnitude of adjustment in the extensive margin is negligible. Therefore, even with selection into exporting, most of the adjustment in trade flows derive from changes in trade by incumbent exporters. We subsequently show that the size of the extensive margin adjustment is exaggerated when left truncated data are used in estimation.

<sup>27</sup>As the name suggests, the “average-to-minimum ratio” in a destination-year distribution is constructed as the ratio of average sales to smallest sales record observed.

<sup>28</sup>The theoretical average-to-minimum ratio in equation (12) is not defined when the value of  $\lambda_R < 1$ . Hence, in this case, a solution for the entry threshold cannot be found. For those observations, we proceed by evaluating the probability mass,  $g_{ij}(\cdot)/(1 - G_{ij}(\cdot))$ , at the minimum value of log-export sales. Given that the distribution of log-export sales and the distribution of profitability differ by a constant (see equation (11)), the shift of a distribution by a constant does not affect the mass at a corresponding truncation point.

<sup>29</sup>Without loss of generality for the decomposition of trade elasticity into intensive and extensive margins, we assume  $\epsilon = 6$ . This value lies within the range used in the literature, see Broda and Weinstein (2006) and Bas et al. (2015). Subsequent results on the extensive margin contribution to the partial trade elasticity do not depend on the particular value we choose.

## 6.1 Trade Elasticity Estimates

Panel A in Table 3 reports summary statistics of the estimated values of the extensive margin elasticities,  $\gamma_{ij}$ . Result 2 summarizes the contents of the table, as follows.

**Result 2** (*Quantitative magnitude of the extensive margin elasticities*)

(i) *The extensive margin contribution to the partial trade elasticity implied by the Double EMG distributions is small, with the average order of magnitude being  $10^{-5}$ .*

(ii) *There is little variation in the extensive margin elasticity across origin-destination country pairs, as the standard deviation across estimates implied by the Double EMG distributions is on the order of  $10^{-4}$ .*

To put the magnitudes reported in Result 2 in perspective, consider the average sample value of the extensive margin elasticity implied by the Double EMG distribution, which equals  $1.3 \cdot 10^{-5}$ . This value should be understood in the context of equation (9), where the partial trade elasticity for an average observation equals  $(1 - \epsilon) \cdot (1 + 1.3 \cdot 10^{-5})$ . Given a value for the elasticity of substitution of  $\epsilon = 6$ , a 1% decline in variable trade costs will increase trade by 5.0001%, to which the entry and exit of firms contribute only 0.0001%. To further emphasize the small magnitude of the extensive margin adjustment, suppose that a 1% decline in variable trade costs leads to 500 million dollars in increased export sales. According to equation (9), every one dollar of new trade can be decomposed into an intensive and extensive margin adjustment in the proportion of 1 to  $\gamma_{ij}$ , or 1 to  $1.3 \cdot 10^{-5}$ . Therefore, those 500 million dollars of new trade amount to \$499,993,500 of intensive versus \$6,500 of extensive margin adjustment. Hence, the extensive margin is quantitatively and economically small.

**Discussion:** While the theory advanced in equation (9) attributes all origin-destination specific variation in the partial trade elasticity to variation in the extensive margin component, our estimates of the extensive margin component are so small that there is essentially no variation. As a result, nearly all trade adjustment in response to a decline in variable trade costs is accounted for by changes on the intensive margin. This is confirmed in the last two columns of Table 3, which reports that the partial trade elasticity exhibits negligible variation across destinations ( $3.5 \cdot 10^{-4}$ ) and has an average value that approximately equals the level of the partial trade elasticity ( $\epsilon - 1 = 5$ ).<sup>30</sup> Therefore, even though selection into

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<sup>30</sup> Our analysis does not exclude the possibility that there could be variation in the partial trade elasticity due to variation in the elasticity of substitution,  $\epsilon$ , across destinations. Our results merely indicate that if there is variation in the partial trade elasticity across destinations, then it is not due to the extensive margin.

exporting might exist as an additional channel of adjustment, most of the adjustment to trade is accounted for by changes in trade among incumbent exporters.

The small extensive margin of the partial trade elasticity occurs because entrants account for very little of the change in trade flows. Mechanically, our strategy for identifying the profitability threshold,  $z^*$ , in the extensive margin of the partial trade elasticity (see Section 5.5) relies on sales data from the smallest firm in a given export sales distribution. As shown in Panel D of Table 1, the size of the smallest exporter is about 62,000 times smaller than the size of an average exporter. Accordingly, our quantitative finding that the contribution of the intensive relative to the extensive margin to the trade elasticity in the proportion of 1 to  $\gamma_{ij}$ , or 1 to  $10^{-4}$ , is consistent with the abundance of small firms in the export sales distributions documented in Section 2. Note that this result does not imply that there is little firm turnover when trade costs change, but rather that the entrants account for very little of changes in the value of trade flows.<sup>31</sup>

This result contrasts with previous findings, such as those in Bas, Mayer, and Thoenig (2015). Using a similar identification strategy to this paper’s, that relies on the size of the smallest exporter, Bas et al. (2015) find a significant amount of variation in bilateral trade elasticities in French and Chinese data sets. The standard deviation of bilateral trade elasticities calculated across destinations equals 0.742 in Bas et al. (2015) (see Table 3 therein) versus  $10^{-4}$  in our sample. This difference in variation is likely driven by sample truncation since in the French trade data employed by the authors, small exporters are not always required to report their exports. Excluding the left tail of the export sales distribution would lead to an overestimation of the size of the smallest exporter, and therefore an overestimation of both trade elasticities and their variation across destinations. In the next section, we measure the bias that arises from identifying trade elasticities using truncated micro-data.

## 6.2 Sample Truncation Bias

Data restrictions pose additional challenges to correctly identifying bilateral trade elasticities. In that regard, many customs-level data sets are truncated. For example, as is the case for frequently used European Union export data, exporters are not required to report export sales below a given threshold. This threshold can vary from as low as 700 euros for intra-EU trade with Malta to as large as over 1 million euros for intra-EU trade with

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<sup>31</sup>We would like to note that these conclusions are in part driven by the robust selection mechanism of the model whereby there is a unique fixed selection threshold. An alternative selection mechanism has been proposed in the work of Eaton, Kortum, and Kramarz (2011) and Armenter and Koren (2015) whereby each firm faces a random fixed cost shock. The random selection mechanism can potentially imply a larger role for the extensive margin of the partial trade elasticity since a marginal exporter is no longer necessarily the smallest exporter.

Belgium, Netherlands, or the United Kingdom (EUROSTAT, 2017). These reporting rules are exogenous to the researcher, but they are not without consequence for estimating policy relevant trade statistics.

At a conceptual level, omitting firms below a certain size threshold disproportionately increases the size of the smallest (marginal) firm that is observed by the econometrician, and therefore exaggerates the contribution of a marginal firm to changes in trade arising from changes in variable trade costs. As can be seen from Table 1 and Table 2, a modest sample truncation of \$5,000 reduces the gap between the average and the smallest firm, measured as the average-to-minimum ratio, by a factor of 100 in a typical export sales distribution. Accordingly, a smaller average-to-minimum ratio,  $E_{ij}(e^z|z > z_{ij}^*)/e^{z_{ij}^*}$ , leads to a higher extensive margin of trade elasticity,  $\gamma_{ij}$ , in equation (10). Therefore, given that the size of the smallest exporter identifies the trade elasticity and that truncated samples disproportionately increase the size of the smallest exporters relative to the size of the average exporter, truncated samples are likely to overstate the contribution of the extensive margin of the partial trade elasticity and hence generate misleadingly high variation in bilateral elasticities. We refer to this effect of data truncation on estimated values of a partial trade elasticity as *truncation bias*.<sup>32</sup>

In order to quantify this truncation bias in elasticity estimates, we conduct a set of counterfactual experiments using truncated samples similar to those discussed in Table 2. Recall, that to construct a truncated sample in Table 2, we take the original log-sales data and drop all firm-destination-year observations with a value of exports below \$5,000. We then recompute the average-to-minimum ratio based on the truncated sample, and, using the recovered Double EMG distributions' parameters, recompute the extensive margin elasticities.<sup>33</sup> We run our counterfactual analysis for samples that are truncated at \$5,000, \$50,000, \$100,000,

<sup>32</sup>Equation (10) also assigns a role to the mass of firms at the margin of entry,  $g_{ij}(z^*)/(1 - G_{ij}(z^*))$ , in calculating the extensive margin of the partial trade elasticity. It can be readily shown that  $g_{ij}(z^*)/(1 - G_{ij}(z^*))$  is increasing in  $z^*$  for any truncation below the mode of the Double EMG distribution. Therefore, data truncation also induces a larger value for  $\gamma_{ij}$  through the mass of firms at the margin. We find that this plays a secondary role in our calculations, and hence our focus on the average-to-minimum ratio in the main text.

<sup>33</sup> Note, that since we already fit a truncated Double EMG distribution to compute the partial trade elasticities in Section 6.1, the counterfactuals do not require us to re-estimate the Double EMG distribution parameters. This is due the fact that a Double EMG distribution is uniquely defined by its parameters and the probability density function, and, hence, any truncated version of a given non-truncated distribution is uniquely defined by its truncation point and the same unique set of parameters of the corresponding underlying non-truncated distribution. This approach further helps us to overcome the problem arising from a potential measurement error that stems from the inherent noise in the data set: As we truncate the data, the number of sample points that identify a distribution declines, and therefore the precision of parameter estimates also declines. Using parameter estimates of the truncated distribution fit to the full data as discussed Section 6.1 allows us to demonstrate the bias arising from data truncation rather than a potential bias from the noise in the truncated data.

and \$250,000.

**Result 3** (*Sample Truncation Bias*) Consider a truncated sample due to dropping all firm-destination export sales lower than a given value.

(i) Data truncation generates an upward bias in the extensive margin elasticity estimates. The magnitude of the bias grows as the truncation value increases.

(ii) Data truncation increases the cross-country standard deviation of the extensive margin and partial trade elasticities. The cross-country standard deviation grows as the truncation value increases.

Panel B in Table 3 reports estimates of the trade elasticities for a truncated sample and compares them to the estimates from a full sample. As can be seen from Panel B, a small data truncation of \$5,000 in firm sales per destination yields an upward bias in the extensive margin elasticity estimate. Notice the increase in the average the extensive margin trade elasticity estimate implied by the Double EMG distribution, from  $1.3 \cdot 10^{-5}$  to 0.003. To motivate the size of this bias, suppose again that there were a reduction in variable trade costs that generates a 500 million dollar increase in export sales. The truncated sample estimates attribute \$1.5 million of the increase to trade generated by entering firms, while the non-truncated sample estimates would attribute only \$6,500. Likewise, a larger truncation of \$50,000 in firm sales per destination yields a much larger upward bias in the extensive margin elasticity, from  $1.3 \cdot 10^{-5}$  to 0.042. Again supposing a reduction in variable trade costs that leads to a 500 million dollar increase in export sales, the truncated sample estimates now attribute 20 million dollars of the increase to trade generated by entering firms. As the truncation value increases, so does the amount of the increase that is attributed to trade generated by entering firms.

Finally, the truncated sample generates larger variation in the partial trade elasticity estimates across destination-year observations. The standard deviation of Double EMG distribution-generated partial trade elasticities is  $3.5 \cdot 10^{-4}$  on a non-truncated sample and increases to 0.03 when sample is truncated at \$5,000, and further increases to 0.33 when the sample is truncated at 50,000. The standard deviation derived from truncated samples moves our estimated elasticities closer to those reported in [Bas, Mayer, and Thoenig \(2015\)](#).

Hence, using truncated samples of our data generates false conclusions regarding the magnitude, variation and, therefore, economic significance of extensive margin adjustments.

### 6.3 Welfare Implications

In this section, we quantitatively illustrate how truncation bias can lead to significant errors in the measurement of welfare gains from a reduction in variable trade costs. To make this

exercise as clear as possible, we conduct a standard general equilibrium welfare analysis using a symmetric two-country version of the model outlined in [Section 5](#). In conducting this welfare analysis, our approach is similar to that of [Nigai \(2017\)](#).

To conduct the welfare analysis we must first select model parameters. We calibrate model parameters so that the equilibrium partial trade elasticity in the model matches the partial trade elasticity implied by the a given empirical export sales distribution. Specifically, we calibrate the fixed export cost,  $f_x$  and the variable trade cost,  $\tau$ , to match the two moments that are used to quantify trade elasticities in [Section 5.5](#): the value of the minimum export sales observation and the average-to-minimum ratio of export sales of the empirical distribution under consideration. Next, we perform the calibration procedure separately for each of the four truncated versions of the empirical distribution, which are truncated at values of \$5,000, \$50,000, \$100,000, and \$250,000. All other parameters are set in advance of calibration and do not change across calibrations.<sup>34</sup> For explication, we consider a representative export sales distribution in a given year to a given destination.<sup>35</sup>

Note that since the partial trade elasticity is an endogenous outcome of the model, calibrated parameters  $f_x$  and  $\tau$  will be different for each of the truncated distributions. This is because the calibration targets (the partial trade elasticity and its components) change with the degree of data truncation, as seen in [Table 3](#). As a result, because of truncation bias in measuring partial trade elasticities, parameter values calibrated using truncated distributions will also be mismeasured relative to the parameter values recovered from using a non-truncated distribution. As shown in [Table 4](#), larger truncation leads to overestimation of both parameters. The magnitude of the fixed export cost parameter is overestimated by a factor of 100 to 10,000, relative to the parameter value recovered from the non-truncated distribution. Furthermore, the variable export cost parameter is overestimated by approximately 1% to 10%. This overestimation of the underlying parameters, which is driven by truncation bias in measuring the endogenous partial trade elasticities, leads to error in measuring the welfare gains from a trade liberalization.

In order to demonstrate the relationship between sample truncation bias and the welfare gains from trade, we compute welfare changes from a range of changes in variable trade costs. Specifically, we consider a range of changes in variable trade costs, from a 50 percent decrease to a 50 percent increase relative to the calibrated value of  $\tau$ . We next compare the percent gains in real income, which is the model’s measure of welfare, implied by the full sample to that implied by each of the truncated samples. [Figure 5](#) depicts results of this

<sup>34</sup>As in [Section 5.5](#), we set  $\epsilon = 6$ . Without the loss of generality we set  $L = 10^8$ ,  $J = 30$ ,  $f_d = 1$ .

<sup>35</sup>These results are robust to the choice of years and destinations, and a full set of results are available upon request.

experiment. The horizontal axis measures the percent change in the variable trade costs and the vertical axis measures the welfare wedge. The welfare wedge is obtained by subtracting the percent change in welfare computed using a full sample from that computed using a truncated sample. For example, a value of -2 implies that a truncated sample will predict an increase in welfare that is 2 percentage points less compared to an increase predicted by the full sample.

Figure 5 shows that truncated samples underpredict the magnitude of welfare gains by 1 to 9 percentage points depending on the size of the trade liberalization and the size of the truncation point. For example, when trade costs decline by 20 percent, data that are truncated at \$250,000 dollars will underpredict the percent increase in welfare by 2 percentage points. Furthermore, the larger is the data truncation, the larger is the error in estimating the welfare gains.

The economic significance of these magnitudes can be understood as follows. The magnitude of the lower bound of 1% is comparable to average GDP growth in the U.S. of about 2% per year over the past ten years. Similarly, over the past thirty years average Brazilian GDP growth was 2.5% per year. The upper bound of 9% is comparable with average GDP growth in China of 10% per year since 2000. Therefore, a truncated sample leads to underestimated welfare gains to trade by magnitudes that range from a typical GDP growth experience to a large economic boom, which is an economically significant margin of error.<sup>36</sup>

## 7 Conclusion

New trade theory predicts that welfare gains can be characterized by the share of expenditure on the domestic goods and the partial trade elasticity (the elasticity of trade flows with respect to changes in variable trade costs). In this paper we focus on quantifying the partial trade elasticity, which depends crucially on the distribution governing firm-level heterogeneity, and ask: what is the role of small firms in determining the gains from trade? We find that small firms substantially attenuate the magnitude of the partial trade elasticity and, subsequently, amplify the gains from trade.

We arrive at this answer by using a data set on Brazilian export sales that, unlike standard trade data sets, has not been exogenously left-truncated as a result of custom office rules.

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<sup>36</sup>Separately, we have replicated the results in Section 6 using a Normal distribution of log-sales. We found that the full sample estimates of trade elasticities reported in Table 3 differ by about 67% for an average observation, but are similarly small in their absolute terms. Although these elasticities are quantitatively indistinguishable, their percent difference propagates in the *same proportion* into the error in measuring the welfare gains from trade. The welfare wedge reported in Figure 5 is about 30% larger when computed using a Normal distribution of log-sales. These results are available upon request.

We observe the full export sales distribution. Exploiting the special features of this data, we contribute two stylized facts to the trade literature. First, export sales distributions are not symmetric and, in fact, exhibit high variation in skewness, mostly positive but also negative, across destinations. Second, export sales distributions have both fat right tails *and* fat left tails. While it is well known that the right tail of sales distributions tend to be fat, that the left tail is fat is new to the trade literature.

These stylized facts are puzzling from the perspective of standard distributional assumptions in new trade models: neither the Pareto nor log-Normal distributions exhibit a fat left tail or an ability to generate differences in skewness across export destinations. We confront this puzzle by introducing a distribution that generalizes both the Pareto and log-Normal distributions, the Double Exponentially Modified Gaussian distribution. We demonstrate that, due to its ability to generate different behavior in its two tails and generate variable skewness, the Double Exponentially Modified Gaussian distribution fits the export sales data better than either the Pareto or log-Normal distribution.

We proceed by embedding the Double EMG distribution in a standard model of trade with monopolistic competition to show that if our data set were left-truncated in a way that was consistent with other data sets, then there would be a *truncation bias* in measuring the partial trade elasticity. That is, the extensive margin trade elasticity would be too large. We find the severity of the upward bias is larger for samples with larger truncation points and varies from 0.3% to 14%. We further conduct a counterfactual analysis that demonstrates that the truncation bias leads to underestimation of the gains from trade by 1% to 9%. These magnitudes are comparable to GDP growth rates during moderate to large economic booms.

Therefore, small firms in the left tail of export distributions tend to drive the extensive margin elasticity down. Large extensive margin elasticities that have been computed using left-truncated data overstate the partial trade elasticity and, subsequently, understate the gains from trade.

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## Figures and Tables

Table 1: Properties of the log-sales distribution across destination-year observations over 1990-2001.

Statistic	Mean	Median	Standard Deviation	Min	Max
<i>Panel A: Moment based statistics</i>					
Standard Deviation	2.11	2.12	0.28	1.28	2.77
Skewness	0.03	0.02	0.24	-1.08	1.29
Nonparametric Skew	0.03	0.03	0.06	-0.19	0.21
Kurtosis	3.17	3.03	0.60	2.08	8.14
<i>Panel B: Percentile based statistics</i>					
Interquartile Range	2.82	2.83	0.49	1.50	4.44
Kelly Skewness	0.04	0.04	0.08	-0.30	0.35
Percentile Coefficient of Kurtosis	0.26	0.26	0.02	0.19	0.34
<i>Panel C: Tail parameter estimates</i>					
Top 5%	1.42	1.27	0.62	0.39	6.67
Top 10%	1.18	1.13	0.31	0.49	2.78
Top 15%	1.08	1.04	0.25	0.52	2.58
Bottom 5%	1.21	1.13	0.50	0.44	4.77
Bottom 10%	1.07	1.04	0.29	0.45	3.67
Bottom 15%	1.01	0.98	0.23	0.48	2.77
<i>Panel D: Other</i>					
Average-to-minimum ratio	62,364.20	5,389.58	262,813.20	32.73	2,937,802

Notes: the statistics are reported across 847 destination-year observations where at least 100 firms export.

Table 2: Properties of the log-sales distribution across destination-year observations over 1990-2001, Sample truncated at \$5,000.

Statistic	Mean	Median	Standard Deviation	Min	Max
<i>Panel A: Moment based statistics</i>					
Standard Deviation	1.74	1.74	0.26	1.05	2.44
Skewness	0.59	0.60	0.27	-0.40	2.43
Nonparametric Skew	0.12	0.13	0.07	-0.17	0.38
Kurtosis	2.99	2.86	0.83	1.85	13.02
<i>Panel B: Percentile based statistics</i>					
Interquartile Range	2.52	2.50	0.47	1.36	4.05
Kelly Skewness	0.15	0.16	0.09	-0.22	0.48
Percentile Coefficient of Kurtosis	0.28	0.28	0.02	0.21	0.36
<i>Panel C: Tail parameter estimates</i>					
Top 5%	1.47	1.32	0.73	0.38	11.91
Top 10%	1.22	1.17	0.33	0.47	2.87
Top 15%	1.11	1.07	0.26	0.51	2.70
Bottom 5%	8.61	7.57	4.12	1.04	37.40
Bottom 10%	4.61	4.35	1.45	1.12	11.27
Bottom 15%	3.35	3.22	0.92	1.11	7.07
<i>Panel D: Other</i>					
Average-to-minimum ratio	159.98	105.25	152.46	9.67	942.63

Notes: the statistics are reported across 813 destination-year observations where at least 100 firms export and exprt value per firm-destiantion-year is \$5,000 or more.

Table 3: Trade elasticity estimates.

Truncation Point	Extensive Margin Elasticity, $\gamma_{ij}$		Partial Trade Elasticity, $ (1 - \epsilon)(1 + \gamma_{ij}) $	
	Mean	Std. Dev.	Mean	Std. Dev.
<i>Panel A: Elasticity Estimates - Full Sample</i>				
No truncation	$1.3 \cdot 10^{-5}$	$7.0 \cdot 10^{-5}$	5.00	$3.5 \cdot 10^{-4}$
<i>Panel B: Elasticity Estimates - Truncated Samples</i>				
\$5,000	0.003	0.006	5.02	0.03
\$50,000	0.042	0.066	5.21	0.33
\$100,000	0.075	0.122	5.37	0.61
\$250,000	0.144	0.267	5.72	1.33
<i>Panel C: Sample Truncation Bias</i>				
\$5,000			1.003	0.006
\$50,000			1.042	0.066
\$100,000			1.075	0.122
\$250,000			1.144	0.267

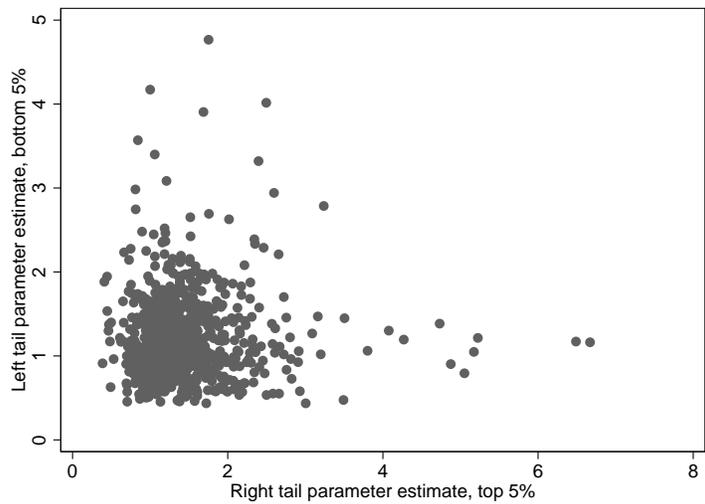
Notes: Panel A reports sample means and standard deviations of the corresponding elasticity estimates. Panel B of the table reports sample means and standard deviations of the elasticity estimates from truncated samples as indicated in the first column. Panel C reports statistics for the ratio of the corresponding elasticity estimates from a truncated sample relative to the full sample. To compute the partial trade elasticity, the value of  $\epsilon = 6$  is assumed.

Table 4: Calibrated Parameters.

Truncation Point	Fixed Export	Variable Export
	Cost, $f_x$	Cost, $\tau$
No truncation	1.5	1.48
\$5,000	833	1.50
\$50,000	8,333	1.55
\$100,000	16,741	1.58
\$250,000	42,200	1.63

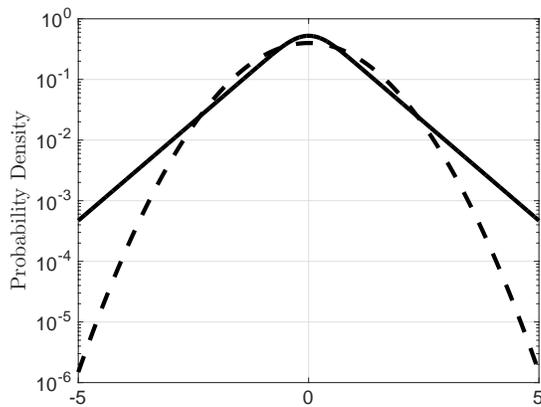
Notes: the table reports calibrated parameter values for each of the corresponding samples.

Figure 1: Heterogeneity in the tail index estimates of log-sales distributions across export destinations.



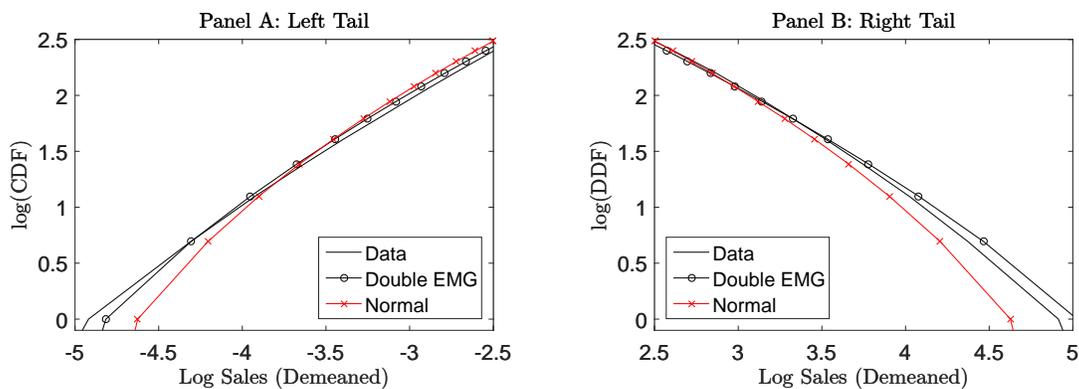
Notes: The figure depicts a scatter plot of the right and left tail index estimates for for the top and bottom 5% of firms. Each dot in the figure corresponds to an estimate of the right and left tail indexes for a given destination-year observation. A sample of 847 destination-year observations where at least 100 firms export.

Figure 2: An example of a Normal and a Double EMG distribution.



Notes: The figure depicts two probability density function (pdf) for two distribution with zero mean and unit variance. The solid line depicts a pdf for an symmetric EMG disquisition with tail parameters equal to 1.5. The dashed line depicts a pdf for a Normal distribution. The y-axis is plotted on the log scale.

Figure 3: Comparison of model errors and tail properties.



Notes: Each panel of the figure presents observations that have been averaged over each destination-year pair.

Figure 4: Goodness of fit statistics across each destination-year observation.

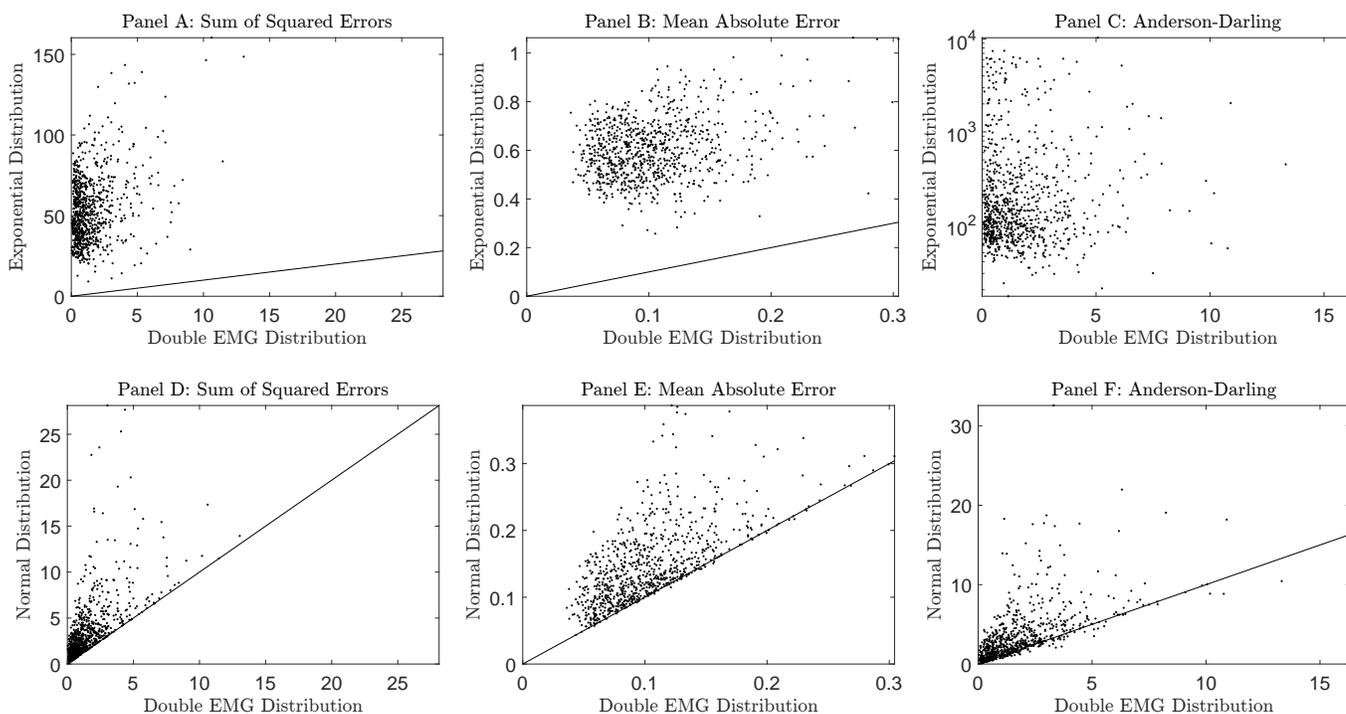
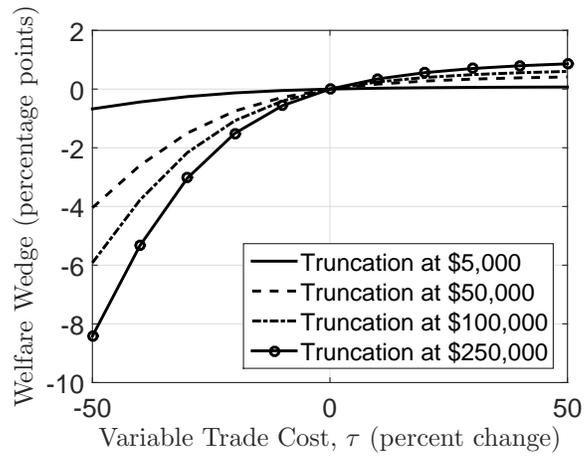


Figure 5: Counterfactual welfare changes.



Notes: The figure plots the values obtained by subtracting the percent change in welfare obtained using the full sample counterfactual, from that obtain using a corresponding truncated sample counterfactual.

## Appendix

### A Proofs of Propositions (For Online Publication Only)

**Proposition 1** *Let  $x$  and  $y$  be independent random variables such that  $x \sim \mathcal{N}(\mu, \sigma^2)$ ,  $y \sim \mathcal{DE}(\lambda_L, \lambda_R)$  and parameters satisfy  $\mu \in \mathbb{R}$ ,  $\sigma > 0$ , and  $\lambda_L, \lambda_R > 0$ . The random variable  $z \equiv x + y$  has the cumulative distribution function  $G : \mathbb{R} \rightarrow [0, 1]$  given by:*

$$G(z) = \Phi\left(\frac{z - \mu}{\sigma}\right) - \frac{\lambda_L}{\lambda_L + \lambda_R} e^{-\lambda_R(z - \mu) + \frac{\sigma^2}{2}\lambda_R^2} \Phi\left(\frac{z - \mu}{\sigma} - \lambda_R\sigma\right) + \frac{\lambda_R}{\lambda_L + \lambda_R} e^{\lambda_L(z - \mu) + \frac{\sigma^2}{2}\lambda_L^2} \Phi\left(-\frac{z - \mu}{\sigma} - \lambda_L\sigma\right),$$

*the density function:*

$$g(z) = \frac{\lambda_L \lambda_R}{\lambda_L + \lambda_R} \left[ e^{-\lambda_R(z - \mu) + \frac{\sigma^2}{2}\lambda_R^2} \Phi\left(\frac{z - \mu}{\sigma} - \lambda_R\sigma\right) + e^{\lambda_L(z - \mu) + \frac{\sigma^2}{2}\lambda_L^2} \Phi\left(-\frac{z - \mu}{\sigma} - \lambda_L\sigma\right) \right],$$

*and the moment generating function:*

$$M_z(t) = \frac{\lambda_L \lambda_R}{(\lambda_L + t)(\lambda_R - t)} e^{\mu t + \frac{\sigma^2}{2} t^2}.$$

#### Proof of Proposition 1

Consider Lemma 1 below.

**Lemma 1** *Let  $x$  and  $y$  be independent random variables such that  $x \sim \mathcal{N}(\mu, \sigma^2)$ ,  $y \sim \mathcal{E}(\lambda)$  and parameters satisfy  $\mu \in \mathbb{R}$ ,  $\sigma > 0$ , and  $\lambda > 0$ . The random variable  $z \equiv x + y$  has the cumulative distribution function  $G : \mathbb{R} \rightarrow [0, 1]$  given by:*

$$G(z) = \Phi\left(\frac{z - \mu}{\sigma}\right) - e^{-\lambda z + (\mu\lambda + \frac{\sigma^2}{2}\lambda^2)} \Phi\left(\frac{z - \mu}{\sigma} - \lambda\sigma\right),$$

*the density function:*

$$g(z) = \lambda e^{-\lambda z + (\mu\lambda + \frac{\sigma^2}{2}\lambda^2)} \Phi\left(\frac{z - \mu}{\sigma} - \lambda\sigma\right),$$

and the moment generating function:

$$M_z(t) = \frac{\lambda}{\lambda - t} e^{\mu t + \frac{\sigma^2}{2} t^2}.$$

**Proof of Lemma 1**

Let  $x$  and  $y$  be random variables such that  $x \sim \mathcal{N}(\mu, \sigma^2)$ ,  $y \sim \mathcal{E}(\lambda)$  and parameters satisfy  $\mu \in \mathbb{R}$ ,  $\sigma > 0$  and  $\lambda > 0$ . For notational convenience, denote the density function that corresponds to the Normal distribution  $\mathcal{N}(\mu, \sigma^2)$  by  $f(x) = (1/\sigma)\phi((x - \mu)/\sigma)$ . In the following derivations, we will make use of the conditional expectation for log-Normal random variables:

$$\int_{x^*}^{+\infty} (e^x)^\kappa f(x) dx = e^{\kappa\mu + \frac{1}{2}\kappa^2\sigma^2} \left( 1 - \Phi \left( \frac{x^* - \mu}{\sigma} - \kappa\sigma \right) \right)$$

Let the random variable  $z \equiv x + y$  have the distribution function  $G : \mathbb{R} \rightarrow [0, 1]$ , which we now derive:

$$\int_{-\infty}^{z^*} z g(z) dz = \text{Prob}(x + y < z^*) = \int_{-\infty}^{z^*} (1 - e^{-\lambda(z^* - x)}) f(x) dx$$

Using the conditional expectation for log-Normal random variables, we obtain:

$$G(z^*) = \Phi \left( \frac{z^* - \mu}{\sigma} \right) - e^{-\lambda z^* + (\lambda\mu + \frac{1}{2}\lambda^2\sigma^2)} \Phi \left( \frac{z^* - \mu - \lambda\sigma^2}{\sigma} \right)$$

Next we derive the density function:

$$\begin{aligned} \frac{\partial}{\partial z} \int_{-\infty}^z z dG(z) &= \int_{-\infty}^z \lambda e^{-\lambda y} f(z - y) dy \\ &= \frac{\lambda}{\sqrt{2\pi}\sigma} \int_{-\infty}^z e^{-\lambda y - \frac{1}{2} \left( \frac{z - y - \mu}{\sigma} \right)^2} dy \\ &= \frac{\lambda}{\sqrt{2\pi}\sigma} e^{-\lambda z + \lambda\mu + \frac{1}{2}\lambda^2\sigma^2} \int_{-\infty}^z e^{-\frac{1}{2} \left( \frac{z - y - \mu - \lambda\sigma^2}{\sigma} \right)^2} dy \\ g(z) &= \lambda e^{-\lambda z + (\lambda\mu + \frac{1}{2}\lambda^2\sigma^2)} \Phi \left( \frac{z - \mu - \lambda\sigma^2}{\sigma} \right) \end{aligned}$$

Lastly, we derive the moment generating function. To do so, we will appeal to an intermediate

result, that if  $g(z)$  is a density function then it must integrate to one:

$$\begin{aligned} \int_{-\infty}^{+\infty} g(z)dz &= \int_{-\infty}^{+\infty} \lambda e^{-\lambda z + (\lambda\mu + \frac{1}{2}\lambda^2\sigma^2)} \Phi\left(\frac{z - \mu - \lambda\sigma^2}{\sigma}\right) dz \\ &= e^{-\frac{1}{2}\lambda^2\sigma^2} \int_{-\infty}^{+\infty} \lambda\sigma e^{-\lambda\sigma y} \int_{-\infty}^y \frac{1}{\sqrt{2\pi}} e^{-\frac{1}{2}x^2} dx dy \end{aligned}$$

where we have used the change of variables  $y = (z - \mu - \lambda\sigma^2)/\sigma$ . Then we know that:

$$\int_{-\infty}^{+\infty} \lambda\sigma e^{-\lambda\sigma y} \int_{-\infty}^y \frac{1}{\sqrt{2\pi}} e^{-\frac{1}{2}x^2} dx dy = e^{\frac{1}{2}\lambda^2\sigma^2}$$

Given this result, we can use the change of variables  $y = (z - \mu - \lambda\sigma^2)/\sigma$  to derive the moment generating function:

$$\begin{aligned} M_z(t) &= \int_{-\infty}^{+\infty} e^{-tz} \lambda e^{-\lambda z + (\lambda\mu + \frac{1}{2}\lambda^2\sigma^2)} \Phi\left(\frac{z - \mu - \lambda\sigma^2}{\sigma}\right) dz \\ &= \frac{\lambda}{\lambda - t} e^{-\frac{1}{2}\lambda^2\sigma^2 + t(\mu + \lambda\sigma^2)} \cdot \int_{-\infty}^{+\infty} (\lambda - t)\sigma e^{-(\lambda-t)\sigma y} \int_{-\infty}^y \frac{1}{\sqrt{2\pi}} e^{-\frac{1}{2}x^2} dx dy \\ &= \frac{\lambda}{\lambda - t} e^{-\frac{1}{2}\lambda^2\sigma^2 + t(\mu + \lambda\sigma^2)} \cdot e^{\frac{1}{2}(\lambda-t)^2\sigma^2} \\ &= \frac{\lambda}{\lambda - t} \cdot e^{\mu t + \frac{\sigma^2}{2}t^2} \end{aligned}$$

Note that the MGF for the EMG is the product of the MGF for the Exponential distribution and the MGF for the  $\mathcal{N}(\mu, \sigma^2)$  distribution. QED.

Deriving the cumulative distribution function, density function and moment generating function of the Double Exponentially Modified Gaussian distribution follows steps from the proof for Lemma 1. The main difference is that the Double Exponential distribution changes functional form at its kink,  $y = 0$ . ■

**Proposition 2** (*Limiting Results*) *Let  $z$  be a Double Exponentially Modified Gaussian distributed random variable with parameters  $(\mu, \sigma, \lambda_L, \lambda_R)$ . The random variable  $z$  is (i) an Exponentially Modified Gaussian distributed random variable as  $\lambda_L$  goes to infinity, (ii) an Exponentially Modified Gaussian distributed random variable with a Normal right tail and Exponential left tail as  $\lambda_R$  goes to infinity, (iii) a Double Exponentially distributed random variable as  $\sigma$  goes to zero, where if  $\mu \neq 0$  then this limiting distribution is a shifted Double Exponential distribution, and (iv) an Exponentially distributed random variable as  $\sigma$  goes to zero and  $\lambda_L$  goes to infinity.*

**Proof of Proposition 2**

Consider Lemma 2 below.

**Lemma 2** *Let  $z$  be an Exponentially Modified Gaussian distributed random variable with parameters  $(\mu, \sigma, \lambda)$ . The random variable  $z$  is Normally distributed in the limit as  $\lambda$  goes to infinity, that is,*

$$\lim_{\lambda \rightarrow +\infty} \left[ \Phi \left( \frac{z - \mu}{\sigma} \right) - e^{-\lambda z + (\mu\lambda + \frac{\sigma^2}{2}\lambda^2)} \Phi \left( \frac{z - \mu}{\sigma} - \lambda\sigma \right) \right] = \Phi \left( \frac{z - \mu}{\sigma} \right).$$

Furthermore, the random variable  $z$  is exponentially distributed in the limit as  $\sigma$  goes to zero.

That is

$$\lim_{\sigma \rightarrow 0} \left[ \Phi \left( \frac{z - \mu}{\sigma} \right) - e^{-\lambda z + (\mu\lambda + \frac{\sigma^2}{2}\lambda^2)} \Phi \left( \frac{z - \mu}{\sigma} - \lambda\sigma \right) \right] = 1 - e^{-\lambda(z-\mu)},$$

where, if  $\mu > 0$  then this limiting distribution is a shifted Exponential distribution on  $(\mu, +\infty)$ . Lastly, consider the limit with respect to the value of the random variable  $z$ . There exists a value of  $z$  denoted  $\bar{z}$  such that  $\forall z \geq \bar{z}$  the distribution  $G(z)$  approaches a shifted Exponential distribution:

$$\left[ \Phi \left( \frac{z - \mu}{\sigma} \right) - e^{-\lambda z + (\mu\lambda + \frac{\sigma^2}{2}\lambda^2)} \Phi \left( \frac{z - \mu}{\sigma} - \lambda\sigma \right) \right] \approx 1 - e^{-\lambda z + (\mu\lambda + \frac{\sigma^2}{2}\lambda^2)}.$$

**Proof of Lemma 2**

We will consider each of the three limits of  $G(z)$  in turn:

$$(a) \lambda \rightarrow +\infty, \quad (b) \sigma \rightarrow 0, \quad (c) z \rightarrow +\infty$$

(a) We first take the limit of  $G(z)$  as  $\lambda \rightarrow +\infty$ . We know that

$$\lim_{\lambda \rightarrow +\infty} \Phi \left( \frac{z - \mu - \lambda\sigma^2}{\sigma} \right) = \lim_{\lambda \rightarrow +\infty} e^{-\lambda z} = 0 \quad \forall z \in \bar{\mathbb{R}}, z \neq 0$$

We must now show that  $\exp(\lambda\mu + \lambda^2\sigma^2/2)$  reaches  $+\infty$  at a slower rate than  $\exp(-\lambda z) \times \Phi((z - \mu - \lambda\sigma^2)/\sigma)$  reaches 0. To do so, we appeal to l'Hôpital's rule:

$$\lim_{\lambda \rightarrow +\infty} \frac{\frac{\partial}{\partial \lambda} e^{-\lambda z} \Phi \left( \frac{z - \mu - \lambda\sigma^2}{\sigma} \right)}{\frac{\partial}{\partial \lambda} e^{\lambda\mu + \frac{1}{2}\lambda^2\sigma^2}} = \lim_{\lambda \rightarrow +\infty} \frac{-z\Phi \left( \frac{z - \mu - \lambda\sigma^2}{\sigma} \right) + \frac{1}{\sigma}\phi \left( \frac{z - \mu - \lambda\sigma^2}{\sigma} \right)}{\mu + \lambda\sigma^2} e^{-\lambda z - \lambda\mu - \frac{1}{2}\lambda^2\sigma^2} = 0$$

The limit equals zero since  $e^{\lambda^2\sigma^2}$  converges to zero faster than linearly, e.g. faster than  $\lambda\sigma^2$ .

(b) Next take the limit as  $\sigma \rightarrow 0$ . Let  $\mu > 0$ . As  $\sigma$  approaches 0, the Normal density

becomes a point mass at  $\mu$  and therefore:  $\Phi\left(\frac{z-\mu}{\sigma}\right) = 1[z \geq \mu]$ . Then clearly the limit of  $G(z)$  as  $\sigma$  approaches 0 equals  $1 - \exp(-\lambda(z - \mu))$  on  $(\mu, +\infty)$  and zero elsewhere.

(c) Lastly, we show that there exists some  $\bar{z}$  such that for all  $z \geq \bar{z}$ ,  $G(z) \approx 1 - \exp(-\lambda(z - \mu - \frac{1}{2}\lambda\sigma^2))$ . We must show that as  $z \rightarrow +\infty$ ,  $\exp(-\lambda z)$  approaches 0 at a slower rate than  $\Phi\left(\frac{z-\mu-\lambda\sigma^2}{\sigma}\right)$  approaches 1. To do so, apply l'Hôpital's rule:

$$\lim_{z \rightarrow +\infty} \frac{e^{-\lambda z}}{\Phi\left(\frac{z-\mu-\lambda\sigma^2}{\sigma}\right)} = \lim_{z \rightarrow +\infty} \frac{-\lambda e^{-\lambda z}}{\frac{1}{\sigma}\phi\left(\frac{z-\mu-\lambda\sigma^2}{\sigma}\right)} \propto \lim_{z \rightarrow +\infty} e^{-\left(\lambda + \frac{\mu+\lambda\sigma^2}{\sigma^2}\right)z + \frac{1}{2}\left(\frac{z}{\sigma}\right)^2} = +\infty$$

Therefore, since both functions are decreasing in  $z$ ,  $\exp(-\lambda z)$  approaches 0 slower than  $\Phi\left(\frac{z-\mu-\lambda\sigma^2}{\sigma}\right)$  approaches 1. Therefore, there exists  $\bar{z}$  sufficiently large such that:

$$\forall z \geq \bar{z} \quad \Phi\left(\frac{z-\mu}{\sigma}\right) \approx 1 \quad \text{and} \quad \Phi\left(\frac{z-\mu-\lambda\sigma^2}{\sigma}\right) \approx 1$$

and

$$G(z) \approx 1 - e^{-\lambda z + \left(\mu\lambda + \frac{\sigma^2}{2}\lambda^2\right)}$$

Therefore for sufficiently large values of  $z$ , the EMG is approximated by a shifted Exponential distribution. QED.

Deriving limiting results for the Double EMG distributions follows similar steps to the proof of Lemma 2. ■

**Proposition 3** *If  $z$  is a Double Exponentially Modified Gaussian distributed random variable on  $(-\infty, +\infty)$  then the skewness of  $z$  is given by*

$$skew(z) = 2 \left( \frac{1}{\sigma^3 \lambda_R^3} - \frac{1}{\sigma^3 \lambda_L^3} \right) \left( 1 + \frac{1}{\sigma^2 \lambda_R^2} + \frac{1}{\sigma^2 \lambda_L^2} \right)^{-\frac{3}{2}}.$$

Furthermore, the sign of  $skew(z)$  is determined by the relative size of the tail parameters:

$$\left\{ \begin{array}{ll} skew(z) > 0 & \text{if } \lambda_L > \lambda_R, \\ skew(z) = 0 & \text{if } \lambda_L = \lambda_R, \\ skew(z) < 0 & \text{if } \lambda_L < \lambda_R. \end{array} \right\}$$

### Proof of Proposition 3

Given the moment generating function for the Double Exponentially Modified Gaussian

distribution, we use the cumulant generating function defined as:

$$C_z(t) \equiv \log(M_z(t)) = \log(\lambda_R \lambda_L) - \log(\lambda_R - t) - \log(\lambda_L + t) + \left( \mu t + \frac{\sigma^2}{2} t^2 \right).$$

The  $n$ -th centered moment is given by the  $n$ -th derivative of  $C_z(t)$  evaluated at zero, or  $C_z^{(n)}(0)$ . Therefore, the mean and variance are:

$$\begin{aligned} C'_z(t) &= \mu - \frac{1}{\lambda_R - t}(-1) - \frac{1}{\lambda_L + t} \\ C''_z(t) &= \sigma^2 + \frac{-1}{(\lambda_R - t)^2}(-1) - \frac{-1}{(\lambda_L + t)^2} \\ C'''_z(t) &= \frac{-2}{(\lambda_R - t)^3}(-1) + \frac{-2}{(\lambda_L + t)^2} \end{aligned}$$

which yield the first three centered moments of the Double Exponentially Modified Gaussian Distribution:

$$\begin{aligned} E[x] = C'_z(0) &= \mu + \frac{1}{\lambda_R} - \frac{1}{\lambda_L} \\ E[(x - E[x])^2] = C''_z(0) &= \sigma^2 + \frac{1}{\lambda_R^2} + \frac{1}{\lambda_L^2} \\ E[(x - E[x])^3] = C'''_z(0) &= 2 \left( \frac{1}{\lambda_R^3} - \frac{1}{\lambda_L^3} \right) \end{aligned}$$

Therefore the skewness of the Double EMG distribution is:

$$skew(z) = \frac{2 \left( \frac{1}{\lambda_R^3} - \frac{1}{\lambda_L^3} \right)}{\left( \sigma^2 + \frac{1}{\lambda_R^2} + \frac{1}{\lambda_L^2} \right)^{3/2}} = 2 \left( \frac{1}{\sigma^3 \lambda_R^3} - \frac{1}{\sigma^3 \lambda_L^3} \right) \left( 1 + \frac{1}{\sigma^2 \lambda_R^2} + \frac{1}{\sigma^2 \lambda_L^2} \right)^{-3/2}.$$

Notice that the skewness can also be expressed as

$$skew(z) = 2 \frac{\lambda_L^3 - \lambda_R^3}{(\sigma^2 \lambda_R^2 \lambda_L^2 + \lambda_L^2 + \lambda_R^2)^{3/2}}.$$

The sign properties of the skewness follow immediately. ■

## B Baseline Trade Model (For Online Publication Only)

## B.1 Economic Environment

There are  $N$  countries. We will denote by  $i$  the origin country and by  $j$  a destination country. Each country  $j$  is populated by  $L_j$  identical consumers with preferences given by a constant elasticity of substitution utility function given by

$$U_j = \left( \sum_{i=1}^N \int_{\omega \in \Omega_{ij}} (e^{\theta_{ij}(\omega)})^{\frac{1}{\epsilon}} c_{ij}(\omega)^{\frac{\epsilon-1}{\epsilon}} d\omega \right)^{\frac{\epsilon}{\epsilon-1}}, \quad (13)$$

where  $\Omega_{ij}$  is the set of varieties consumed in country  $j$  originating from country  $i$ ,  $c_{ij}(\omega)$  is the consumption of variety  $\omega \in \Omega_{ij}$ ,  $\epsilon$  is the elasticity of substitution, and  $\theta_{ij}(\omega)$  is the demand parameter for variety  $\omega \in \Omega_{ij}$ .<sup>37</sup>

Each consumer owns a share of domestic firms and is endowed with one unit of labor that is inelastically supplied to the market. Cost minimization yields optimal demand for variety  $\omega \in \Omega_{ij}$  given by

$$c_{ij}(\omega) = e^{\theta_{ij}(\omega)} p_{ij}(\omega)^{-\epsilon} Y_j P_j^{\epsilon-1}, \quad (14)$$

where  $p_{ij}(\omega)$  is the price of variety  $\omega \in \Omega_{ij}$ ,  $Y_j$  is income in country  $j$  and  $P_j$  is the aggregate price index in country  $j$ . The aggregate price index is given by

$$P_j^{1-\epsilon} = \sum_{i=1}^N \int_{\omega \in \Omega_{ij}} e^{\theta_{ij}(\omega)} p_{ij}(\omega)^{1-\epsilon} d\omega. \quad (15)$$

## B.2 Supply

As in [Chaney \(2008\)](#), each country is endowed with the exogenous mass  $J_i$  of prospective entrants. Upon entry, a firm is endowed with an idiosyncratic labor productivity level  $\varphi$  and a destination-specific demand parameter  $\theta_j$ . Productivity and destination-specific demand parameters are drawn from separate independent distributions. Firms face fixed  $f_{ij}$  and variable  $\tau_{ij}$  costs of selling from country  $i$  to country  $j$  denominated in terms of units of labor.

Once productivity and demand are realized, firms compete in a monopolistically competitive environment. Firms maximize profits subject to the consumer demand (14) yielding

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<sup>37</sup>[Bernard, Redding, and Schott \(2010\)](#) interpret  $\theta_{ij}(\omega)$  as variations in consumer tastes or relative demand across different varieties. In [Timoshenko \(2015\)](#)  $\theta_{ij}(\omega)$  represents product demand that firms need to learn over time through market participation.

the optimal price given by

$$p_{ij}(\varphi) = \frac{\epsilon}{\epsilon - 1} \frac{\tau_{ij} w_i}{\varphi},$$

where  $w_i$  is the wage in country  $i$ . The corresponding firm's optimal revenues and profits are given by

$$r_{ij}(\theta_{ij}, \varphi) = \left( \frac{\epsilon - 1}{\epsilon} \right)^{\epsilon - 1} (\tau_{ij} w_i)^{1 - \epsilon} Y_j P_j^{\epsilon - 1} e^{\theta_{ij}} \varphi^{\epsilon - 1}, \quad (16)$$

$$\pi_{ij}(\theta_{ij}, \varphi) = \frac{r_{ij}(\theta_{ij}, \varphi)}{\epsilon} - w_i f_{ij}. \quad (17)$$

Notice from equations (16) and (17) that a firm's profitability in market  $j$  depends on both a firm's productivity  $\varphi$  and a demand parameter  $\theta_j$  in a multiplicative way. Hence a low productivity firm can generate positive profits if the demand for its product is high, and vice versa. Thus, selection into a market occurs based on a firm's profitability, and not productivity or demand alone. Denote by  $z_{ij}$  the firm's payoff relevant state variable given by

$$z_{ij} = \theta_{ij} + \log(\varphi^{\epsilon - 1}). \quad (18)$$

We will refer to  $z_{ij}$  as a firm's *profitability* in market  $j$ . Given  $z_{ij}$ , we can rewrite the firm's optimal revenue and profit as a function of profitability  $z_{ij}$  as

$$r_{ij}(z_{ij}) = \left( \frac{\epsilon - 1}{\epsilon} \right)^{\epsilon - 1} (\tau_{ij} w_i)^{1 - \epsilon} Y_j P_j^{\epsilon - 1} e^{z_{ij}}. \quad (19)$$

$$\pi_{ij}(z_{ij}) = \frac{r_{ij}(z_{ij})}{\epsilon} - w_i f_{ij}. \quad (20)$$

Since there are no sunk entry costs, the profitability entry threshold is determined by the zero-profit condition  $\pi_{ij}(z_{ij}^*) = 0$  and is given by

$$e^{z_{ij}^*} = \frac{\epsilon w_i f_{ij} (w_i \tau_{ij})^{\epsilon - 1}}{\left( \frac{\epsilon - 1}{\epsilon} \right)^{\epsilon - 1} Y_j P_j^{\epsilon - 1}}. \quad (21)$$

The firm's optimal revenue can then be written as a function of a firm's profitability,  $z_{ij}$ , and the profitability entry threshold  $z_{ij}^*$  as

$$r_{ij}(z_{ij}) = \epsilon w_i f_{ij} \frac{e^{z_{ij}}}{e^{z_{ij}^*}}. \quad (22)$$

### B.3 Trade Elasticity

The value of exports from country  $i$  to country  $j$  is defined as

$$X_{ij} = M_{ij} \int_{z_{ij}^*}^{+\infty} r_{ij}(z) \frac{g_{ij}(z)}{1 - G_{ij}(z)} dz, \quad (23)$$

where  $M_{ij}$  is the equilibrium mass of firms selling from country  $i$  to country  $j$  and is given by

$$M_{ij} = J_i(1 - G_{ij}(z_{ij}^*)). \quad (24)$$

The cumulative and the probability distribution functions of firms profitabilities are denoted by  $G_{ij}(z)$  and  $g_{ij}(z)$  correspondingly.

Proposition 4 below establishes the partial trade elasticity result.

**Proposition 4** *The partial elasticity of trade flows with respect to variable trade costs is given by*

$$\frac{\partial \log X_{ij}}{\partial \log \tau_{ij}} = (1 - \epsilon)(1 + \gamma_{ij}),$$

where  $\gamma_{ij}$  given by

$$\gamma_{ij} = \frac{g_{ij}(z_{ij}^*)}{(1 - G_{ij}(z_{ij}^*))} \frac{e^{z_{ij}^*}}{E_{ij}(e^z | z > z_{ij}^*)}.$$

**Proof:** Substitute equations (22) and (24) into equation (23) to obtain

$$X_{ij} = \epsilon J_i w_i f_{ij} \int_{z_{ij}^*}^{+\infty} (e^{z_{ij} - z_{ij}^*}) g_{ij}(z) dz.$$

Using the Leibniz's Integration Rule:

$$\begin{aligned} \frac{\partial X_{ij}}{\partial \tau_{ij}} &= \epsilon J_i w_i f_{ij} \left[ -\frac{\partial z_{ij}^*}{\partial \tau_{ij}} \int_{z_{ij}^*}^{+\infty} (e^{z_{ij} - z_{ij}^*}) g_{ij}(z) dz - g(z_{ij}^*) \frac{\partial z_{ij}^*}{\partial \tau_{ij}} \right] \\ &= \epsilon J_i w_i f_{ij} \left[ -\frac{\partial z_{ij}^*}{\partial \tau_{ij}} e^{-z_{ij}^*} (1 - G_{ij}(z_{ij}^*)) E_{ij}(e^z | z > z_{ij}^*) - g(z_{ij}^*) \frac{\partial z_{ij}^*}{\partial \tau_{ij}} \right]. \end{aligned}$$

Now we must derive the partial derivative of the profitability threshold with respect to a change in variable costs. To do so, we use the expression characterizing the threshold in

equation (21):

$$\frac{\partial z_{ij}^*}{\partial \tau_{ij}} = \frac{\partial}{\partial \tau_{ij}} \log \left( \frac{\epsilon w_i f_{ij} (w_i \tau_{ij})^{\epsilon-1}}{\left(\frac{\epsilon-1}{\epsilon}\right)^{\epsilon-1}} Y_j P_J^{\epsilon-1} \right) = \frac{\epsilon-1}{\tau_{ij}}.$$

Notice that the value of trade flows can be expressed as

$$X_{ij} = \epsilon J_i w_i f_{ij} e^{-z_{ij}^*} (1 - G_{ij}(z_{ij}^*)) E_{ij}(e^z | z > z_{ij}^*).$$

Therefore, the partial elasticity of trade is:

$$\begin{aligned} \frac{\partial \log X_{ij}}{\partial \log \tau_{ij}} &= \frac{\tau_{ij}}{X_{ij}} \cdot \epsilon J_i w_i f_{ij} \left[ \frac{1-\epsilon}{\tau_{ij}} e^{-z_{ij}^*} (1 - G_{ij}(z_{ij}^*)) E_{ij}(e^z | z > z_{ij}^*) + g(z_{ij}^*) \frac{1-\epsilon}{\tau_{ij}} \right] \\ &= (1-\epsilon) + \frac{g(z_{ij}^*)}{1 - G_{ij}(z_{ij}^*)} \cdot \frac{(1-\epsilon)e^{z_{ij}^*}}{E_{ij}(e^z | z > z_{ij}^*)} \\ &= (1-\epsilon) + (1-\epsilon)\gamma_{ij} \\ &= (1-\epsilon)(1 + \gamma_{ij}). \end{aligned}$$

as desired. ■

## B.4 Conditional Expectations

Finally, we derive the conditional expectation for the Double EMG distribution. Given conditional expectations, it is possible to compute the extensive margin elasticity from [Proposition 4](#). The conditional expectation of the Double EMG distribution in [Proposition 5](#) as follows.

**Proposition 5** *If  $z$  is a Double Exponentially Modified Gaussian distributed random variable on  $(-\infty, +\infty)$  then the conditional first moment on  $(z^*, +\infty)$  is*

$$\begin{aligned} \int_{z^*}^{+\infty} e^z g(z) dz &= M_z(1) \left( 1 - \Phi \left( \frac{z^* - \mu}{\sigma} - \sigma \right) \right) \\ &\quad + \frac{1}{\lambda_R - 1} \frac{\lambda_L \lambda_R}{\lambda_L + \lambda_R} e^{z^* - \lambda_R(z^* - \mu) + \frac{\sigma^2}{2} \lambda_R^2} \Phi \left( \frac{z^* - \mu}{\sigma} - \lambda_R \sigma \right) \\ &\quad - \frac{1}{\lambda_L + 1} \frac{\lambda_L \lambda_R}{\lambda_L + \lambda_R} e^{z^* + \lambda_L(z^* - \mu) + \frac{\sigma^2}{2} \lambda_L^2} \Phi \left( -\frac{z^* - \mu}{\sigma} - \lambda_L \sigma \right). \end{aligned}$$

**Proof:** Let  $x \sim \mathcal{N}(\mu, \sigma^2)$ ,  $y \sim \mathcal{DE}(\lambda_L, \lambda_R)$  and  $z$  be a Double EMG distributed random

variable on  $(-\infty, +\infty)$ . Then the conditional first moment on  $(z^*, +\infty)$  is:

$$\int_{z^*}^{+\infty} e^z G(dz) = \left[ \int_{x>z^*} \int_{y>0} + \int_{x>z^*} \int_{z^*-x}^0 + \int_{x<z^*} \int_{y>z^*-x} \right] e^{x+y} f(x)g(y)dx dy$$

First take each integral in turn and define cases. The first (case is  $y > 0$ ):

$$\int_{x>z^*} \int_{y>0} e^{x+y} f(x)g(y)dx dy = \int_{x>z^*} e^x f(x)dx \cdot \int_{y>0} e^y g(y)dy$$

the second (case is  $y < 0$ ):

$$\int_{x>z^*} \int_{z^*-x}^0 e^{x+y} f(x)g(y)dx dy = \int_{x>z^*} e^x \left[ \int_{z^*-x}^0 e^y g(y)dy \right] f(x)dx$$

and, lastly, the third (case is  $y > 0$ ):

$$\int_{x<z^*} \int_{y>z^*-x} e^{x+y} f(x)g(y)dx dy = \int_{x<z^*} e^x \left[ \int_{y>z^*-x} e^y g(y)dy \right] f(x)dx$$

We can simplify the integrals in each case. Simplifying the first case:

$$\begin{aligned} \int_{z^*}^{+\infty} e^x f(x)dx \cdot \int_0^{+\infty} e^y g(y)dy &= e^{\mu+\frac{\sigma^2}{2}} \Phi\left(-\frac{z^*-\mu-\sigma^2}{\sigma}\right) \cdot \int_0^{\infty} e^y \frac{\lambda_L \lambda_R}{\lambda_L + \lambda_R} e^{-\lambda_L y} dy \\ &= e^{\mu+\frac{\sigma^2}{2}} \Phi\left(-\frac{z^*-\mu-\sigma^2}{\sigma}\right) \cdot \frac{\lambda_R \lambda_L}{\lambda_R + \lambda_L} \frac{-1}{\lambda_R - 1} e^{-(\lambda_R-1)y} \Big|_0^{\infty} \\ &= e^{\mu+\frac{\sigma^2}{2}} \left(1 - \Phi\left(\frac{z^*-\mu-\sigma^2}{\sigma}\right)\right) \cdot \frac{\lambda_R \lambda_L}{\lambda_R + \lambda_L} \frac{1}{\lambda_R - 1} \end{aligned}$$

the second case:

$$\begin{aligned} \int_{x>z^*} e^x \left( \int_{z^*-x}^0 e^y \frac{\lambda_R \lambda_L}{\lambda_R + \lambda_L} e^{\lambda_L y} dy \right) f(x)dx \\ &= \int_{x>z^*} e^x \left( \frac{\lambda_R \lambda_L}{\lambda_R + \lambda_L} \frac{1}{\lambda_L + 1} (1 - e^{(\lambda_L+1)(z^*-x)}) \right) f(x)dx \\ &= \frac{\lambda_R \lambda_L}{\lambda_R + \lambda_L} \frac{1}{\lambda_L + 1} \left( e^{\mu+\frac{\sigma^2}{2}} \Phi\left(-\frac{z^*-\mu-\sigma^2}{\sigma}\right) - e^{(\lambda_L+1)z^*} \int_{x>z^*} e^{-\lambda_L x} f(x)dx \right) \\ &= \frac{\lambda_R \lambda_L}{\lambda_R + \lambda_L} \frac{1}{\lambda_L + 1} \left( e^{\mu+\frac{\sigma^2}{2}} \Phi\left(-\frac{z^*-\mu-\sigma^2}{\sigma}\right) - e^{z^*+\lambda_L(z^*-\mu)+\frac{\lambda_L^2 \sigma^2}{2}} \Phi\left(-\frac{z^*-\mu+\lambda_L \sigma^2}{\sigma}\right) \right) \end{aligned}$$

and, lastly, the third case:

$$\begin{aligned}
 & \int_{x < z^*} e^x \left[ \int_{y > z^* - x} e^y g(y) dy \right] f(x) dx \\
 &= \int_{x < z^*} e^x \left[ \frac{\lambda_R \lambda_L}{\lambda_R + \lambda_L} \frac{-1}{\lambda_R - 1} \left( 0 - e^{-(\lambda_R - 1)(z^* - x)} \right) \right] f(x) dx \\
 &= \frac{\lambda_R \lambda_L}{\lambda_R + \lambda_L} \frac{1}{\lambda_R - 1} e^{-(\lambda_R - 1)z^*} \int_{x < z^*} e^{\lambda_R x} f(x) dx \\
 &= \frac{\lambda_R \lambda_L}{\lambda_R + \lambda_L} \frac{1}{\lambda_R - 1} e^{z^* - \lambda_R(z^* - \mu) + \frac{\lambda_R^2 \sigma^2}{2}} \Phi \left( \frac{z^* - \mu - \lambda_R \sigma^2}{\sigma} \right)
 \end{aligned}$$

Summing these integrals together we obtain:

$$\begin{aligned}
 \int_{z^*}^{+\infty} e^z H(dz) &= e^{\mu + \frac{\sigma^2}{2}} \left( 1 - \Phi \left( \frac{z^* - \mu - \sigma^2}{\sigma} \right) \right) \cdot \frac{\lambda_R \lambda_L}{\lambda_R + \lambda_L} \frac{1}{\lambda_R - 1} \\
 &+ \frac{\lambda_R \lambda_L}{\lambda_R + \lambda_L} \frac{1}{\lambda_L + 1} \left( e^{\mu + \frac{\sigma^2}{2}} \Phi \left( -\frac{z^* - \mu - \sigma^2}{\sigma} \right) - e^{z^* + \lambda_L(z^* - \mu) + \frac{\lambda_L^2 \sigma^2}{2}} \Phi \left( -\frac{z^* - \mu + \lambda_L \sigma^2}{\sigma} \right) \right) \\
 &+ \frac{\lambda_R \lambda_L}{\lambda_R + \lambda_L} \frac{1}{\lambda_R - 1} e^{z^* - \lambda_R(z^* - \mu) + \frac{\lambda_R^2 \sigma^2}{2}} \Phi \left( \frac{z^* - \mu - \lambda_R \sigma^2}{\sigma} \right)
 \end{aligned}$$

Therefore, the final conditional expectation is:

$$\begin{aligned}
 \int_{z^*}^{+\infty} e^z H(dz) &= \frac{\lambda_R \lambda_L}{\lambda_R + \lambda_L} \left( \frac{1}{\lambda_R - 1} + \frac{1}{\lambda_L + 1} \right) e^{\mu + \frac{\sigma^2}{2}} \left( 1 - \Phi \left( \frac{z^* - \mu - \sigma^2}{\sigma} \right) \right) \\
 &+ \frac{\lambda_R \lambda_L}{\lambda_R + \lambda_L} \frac{1}{\lambda_R - 1} e^{z^* - \lambda_R(z^* - \mu) + \frac{\lambda_R^2 \sigma^2}{2}} \Phi \left( \frac{z^* - \mu - \lambda_R \sigma^2}{\sigma} \right) \\
 &- \frac{\lambda_R \lambda_L}{\lambda_R + \lambda_L} \frac{1}{\lambda_L + 1} e^{z^* + \lambda_L(z^* - \mu) + \frac{\lambda_L^2 \sigma^2}{2}} \Phi \left( -\frac{z^* - \mu + \lambda_L \sigma^2}{\sigma} \right)
 \end{aligned}$$

where

$$\frac{\lambda_R \lambda_L}{\lambda_R + \lambda_L} \left( \frac{1}{\lambda_R - 1} + \frac{1}{\lambda_L + 1} \right) = \frac{\lambda_R \lambda_L}{(\lambda_R - 1)(\lambda_L + 1)}$$

as desired. ■

## C Comparison to the Generalized Normal Distribution (For Online Publication Only)

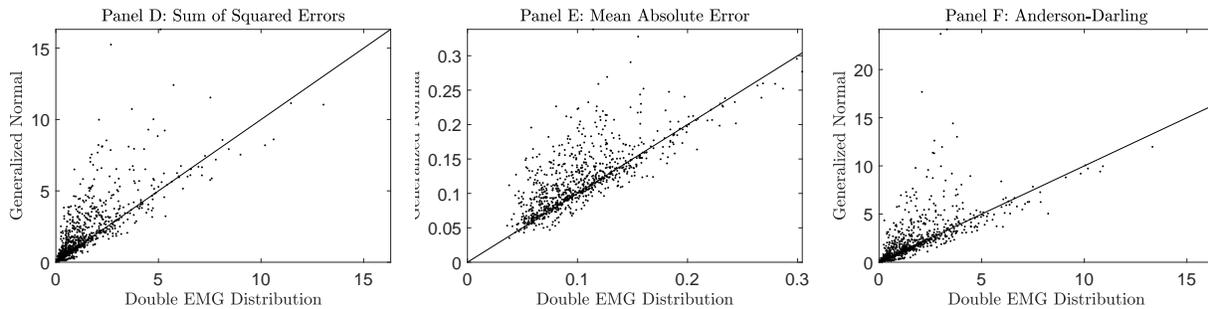
We estimate parameters of the Generalized Normal described by the cumulative density

function  $F^{GN}(x) = \Phi\left(-\frac{1}{\nu} \log\left(1 - \nu \frac{x-\mu}{\sigma}\right)\right)$  for  $\nu \neq 0$  according to the method presented in Section 4 of the paper. We then compare goodness of fit statistics from the fitted Double EMG to fitted Generalized Normal Distributions. Figure C1 reproduces Figure 4 by comparing the Double EMG to the fitted Generalized Normal distributions (as indicated by the labels in the graphs).

Figure C1 demonstrates that for the majority of our observations the Double EMG distribution yields a better fit than the Generalized Normal distribution. The Generalized Normal distribution has more control over the shape of its tails than the Double EMG distribution. While the Double EMG distribution has effectively log-linear tails (which it inherits from the exponential distribution), the Generalized Normal distribution has curvature in its tails. In some cases, the Generalized Normal’s curvature in its tails seemingly helps it match the extreme tails of the export sales distributions relative to the Double EMG distribution. However, the Double EMG distribution yields a better fit on average.

This paper’s choice of Double EMG distribution as its focal point, as opposed to a Generalized Normal distribution for example, is motivated by a desire to maintain a microfounded theory of aggregate outcomes. The Double EMG distribution arises endogenously from the steady state of an economy inhabited by a large number of firms that receive Brownian Motion shocks to productivity and whose initial productivity is normally distributed (see Reed and Jorgensen (2004) and Toda (2014)). Furthermore, the Double EMG distributions generalizes distributions for which previous work has developed a set of baseline results and intuitions. By comparing our results from a new distributional form to results we already understand (e.g., from Exponential and Normal distributions), we can more easily connect our work to previous work on the role of selection and properties of the firm size distribution.

Figure C1: Goodness of fit statistics across each destination-year observation.



## D Robustness (For Online Publication Only)

### D.1 Alternative Origin Country

In this robustness check, we ask whether the novel properties of log-export sales distributions and the truncation bias are specific to Brazilian export sales during 1990-2001. We replicate each of our results using export sales data from a second country and verify that our results are robust to changes in economic environment.

We use Peruvian export data for the period between 1993 and 2009 from the World Bank Exporter Dynamics Database. For the detailed description of the data see [Cebeci et al. \(2012\)](#), [Fernandes et al. \(2016\)](#), and [Freund and Pierola \(2012\)](#). The data set is comparable to the Brazilian export data and reports the value of export sales at the firm-product-destination-year level.

[Table D1](#), [Table D2](#), [Figure D1](#), and [Figure D2](#) reproduce [Table 1](#), [Table 3](#), [Figure 1](#), and [Figure 4](#). We find that all results are qualitatively reproduced in the Peruvian data and in many cases we find that relationships and parameter estimates are quantitatively similar.

### D.2 Product Definition

In this robustness check, we ask whether whether the novel properties of log-export sales distributions and the truncation bias are driven by the particular way in which manufacturing trade is defined in our paper. Specifically, prior to aggregating the data at the firm-destination-year level, we drop any firm-product-destination-year observations for agricultural products. If a firm simultaneously exports manufacturing and agricultural products, our approach can potentially create an abundance of small firms that might not primarily export manufacturing-industry products. Our data set does not contain an indicator of a firm's primary industry of operation. Hence, we check the robustness of our results by dropping all firms that export at least one non-manufacturing product within a destination-year. The firms that remain only export manufacturing products.

Across firm-destination-year bins, 10% of firms export any non-manufacturing products. For an average firm, measured as the unconditional mean across firm-destination-years, non-manufacturing products account for 9% of export revenue. However, for those firms that export any non-manufacturing products, revenues are highly concentrated in non-manufacturing products with non-manufacturing products accounting for 92% of export revenue on average. Therefore, the main text included the remaining 8% of export sales

from these 10% of firms. This section altogether excludes all sales, manufacturing and non-manufacturing, from these 10% of firms.

Table D3, Table D4, and Figure D3 reproduce Table 1, Table 3, and Figure 4. We find that all quantitative results are nearly unchanged.

### D.3 Industrial Composition

In Section 4.2 of the paper we applied the estimation procedure outlined in Section 4.1 to estimate the distribution parameters for each of the observations in our sample. Recall that we define an observation to be a distribution of log-export sales for a given export destination in a given year. We conduct our analysis at the country, rather than country-industry, level to make our results comparable to those in the literature.<sup>38</sup> We acknowledge that properties of distributions might vary with the industrial composition of exports across destinations. To check the robustness of our results, we repeat our estimation for the log-export sales at the destination-year-industry level. We find that there is no statistically significant relationship between industry shares and skewness within destination-year observations. Therefore, no single industry drives tail fatness or skewness across destination-years, and the distribution estimation results remain quantitatively similar.

Table D5 reproduces results from Table 1 and reports statistics over destination-year observations in which each firm's sales of products within a particular industry are demeaned by that industry's destination-year average. The table shows that controlling for industry composition induces negative skewness, fatter left tails and thinner left tails of destination-year(-industry) observations. Therefore, controlling for industry composition artificially shrinks the size of firms across industries and has no economic significance within the class of trade models studied in this paper.

Figure D4 reproduces Figure 4 and shows the Double EMG provides a superior fit to export sales data across destination-year observations. This is because left tails become fatter after controlling for industry composition.

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<sup>38</sup> Head et al. (2014) estimate the distributions of log-export sales of French firms in Belgium and Chinese firms in Japan, Bas et al. (2015) estimate distributions of log-export sales for each of the French and Chinese export destinations, Nigai (2017) for total French exports.

APPENDIX FOR ONLINE PUBLICATION ONLY

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Table D1: Properties of the log-sales distribution across destination-year observations over 1993-2009, Peru.

Statistic	Mean	Meian	Standard Deviation	Min	Max
<i>Panel A: Moment based statistics</i>					
Standard Deviation	2.64	2.62	0.37	1.86	3.82
Skewness	-0.12	-0.13	0.34	-1.23	1.16
Nonparametric Skew	0.02	0.02	0.07	-0.29	0.31
Kurtosis	3.59	3.49	0.75	2.11	7.12
<i>Panel B: Percentile based statistics</i>					
Interquartile Range	3.42	3.37	0.47	2.35	4.96
Kelly Skewness	0.05	0.05	0.11	-0.37	0.53
Percentile Coefficient of Kurtosis	0.26	0.26	0.02	0.15	0.33
<i>Panel C: Tail parameter estimates</i>					
Top 5%	1.17	1.08	0.46	0.42	3.77
Top 10%	0.997	0.96	0.33	0.37	3.16
Top 15%	0.89	0.86	0.25	0.36	1.81
Bottom 5%	0.74	0.63	0.46	0.25	5.22
Bottom 10%	0.69	0.60	0.31	0.31	3.38
Bottom 15%	0.69	0.62	0.25	0.31	2.21
<i>Panel D: Other</i>					
Average-to-minimum ratio	7,113,788.69	205,256.20	33,642,347	219.75	395,262,848

Notes: the statistics are reported across 415 destination-year observations where at least 100 firms export.

Table D2: Trade elasticity estimates, Peru.

Truncation Point	Extensive Margin Elasticity, $\gamma_{ij}$		Partial Trade Elasticity, $ (1 - \epsilon)(1 + \gamma_{ij}) $	
	Mean	Std. Dev.	Mean	Std. Dev.
<i>Panel A: Elasticity Estimates - Full Sample</i>				
No truncation	$2.3 \cdot 10^{-6}$	$2.2 \cdot 10^{-5}$	5.00	$1.1 \cdot 10^{-4}$
<i>Panel B: Elasticity Estimates - Truncated Samples</i>				
\$5,000	0.002	0.003	5.01	0.01
\$50,000	0.023	0.037	5.11	0.19
\$100,000	0.041	0.064	5.20	0.32
\$250,000	0.084	0.136	5.42	0.68
<i>Panel C: Sample Truncation Bias</i>				
\$5,000			1.002	0.003
\$50,000			1.023	0.037
\$100,000			1.041	0.064
\$250,000			1.084	0.136

Notes: Panel A reports sample means and standard deviations of the corresponding elasticity estimates. Panel B of the table reports sample means and standard deviations of the elasticity estimates from truncated samples as indicated in the first column. Panel C reports statistics for the ratio of the corresponding elasticity estimates from a truncated sample relative to the full sample. To compute the partial trade elasticity, the value of  $\epsilon = 6$  is assumed.

Table D3: Properties of the log-sales distribution across destination-year observations over 1990-2001, sample selection robustness.

Statistic	Mean	Median	Standard Deviation	Min	Max
<i>Panel A: Moment based statistics</i>					
Standard Deviation	2.10	2.11	0.28	1.28	2.76
Skewness	0.03	0.02	0.24	-1.07	1.25
Nonparametric Skew	0.03	0.03	0.06	-0.20	0.20
Kurtosis	3.16	3.03	0.58	2.08	8.17
<i>Panel B: Percentile based statistics</i>					
Interquartile Range	2.81	2.82	0.49	1.49	4.31
Kelly Skewness	0.05	0.05	0.08	-0.30	0.35
Percentile Coefficient of Kurtosis	0.26	0.26	0.02	0.19	0.34
<i>Panel C: Tail parameter estimates</i>					
Top 5%	1.43	1.29	0.62	0.40	6.67
Top 10%	1.19	1.14	0.31	0.48	3.05
Top 15%	1.08	1.05	0.25	0.53	2.75
Bottom 5%	1.22	1.14	0.53	0.44	7.51
Bottom 10%	1.08	1.04	0.29	0.45	3.67
Bottom 15%	1.02	0.99	0.24	0.48	2.77
<i>Panel D: Other</i>					
Average-to-minimum ratio	57,927.67	5,083.31	251,338.06	32.73	2,844,461

Notes: the statistics are reported across 845 destination-year observations where at least 100 firms export.

Table D4: Trade elasticity estimates, sample selection robustness.

Truncation Point	Extensive Margin		Partial Trade Elasticity, $ (1 - \epsilon)(1 + \gamma_{ij}) $	
	Mean	Std. Dev.	Mean	Std. Dev.
<i>Panel A: Elasticity Estimates - Full Sample</i>				
No truncation	$1.4 \cdot 10^{-5}$	$7.7 \cdot 10^{-5}$	5.00	$3.8 \cdot 10^{-4}$
<i>Panel B: Elasticity Estimates - Truncated Samples</i>				
\$5,000	0.003	0.006	5.02	0.03
\$50,000	0.043	0.066	5.21	0.33
\$100,000	0.076	0.124	5.38	0.62
\$250,000	0.149	0.286	5.74	1.43
<i>Panel C: Sample Truncation Bias</i>				
\$5,000			1.003	0.006
\$50,000			1.043	0.066
\$100,000			1.076	0.124
\$250,000			1.149	0.286

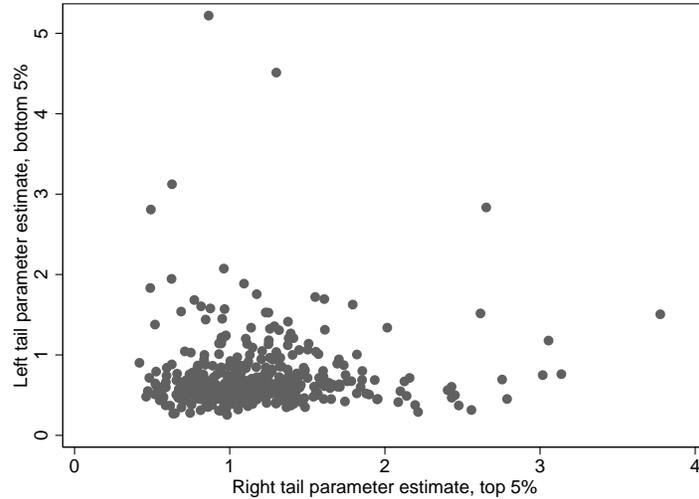
Notes: Panel A reports sample means and standard deviations of the corresponding elasticity estimates. Panel B of the table reports sample means and standard deviations of the elasticity estimates from truncated samples as indicated in the first column. Panel C reports statistics for the ratio of the corresponding elasticity estimates from a truncated sample relative to the full sample. To compute the partial trade elasticity, the value of  $\epsilon = 6$  is assumed.

Table D5: Properties of the log-sales distribution across destination-year observations over 1990-2001, industry composition robustness.

Statistic	Mean	Median	Standard Deviation	Min	Max
<i>Panel A: Moment based statistics</i>					
Standard Deviation	1.99	2.01	0.27	1.25	2.70
Skewness	-0.31	-0.28	0.28	-1.51	0.40
Nonparametric Skew	-0.04	-0.04	0.06	-0.26	0.14
Kurtosis	3.16	3.01	0.65	2.15	8.12
<i>Panel B: Percentile based statistics</i>					
Interquartile Range	2.70	2.72	0.41	1.62	3.86
Kelly Skewness	-0.04	-0.03	0.09	-0.41	0.21
Percentile Coefficient of Kurtosis	0.27	0.27	0.02	0.18	0.34
<i>Panel C: Tail parameter estimates</i>					
Top 5%	2.25	1.93	3.18	0.63	90.45
Top 10%	1.73	1.63	0.54	0.83	8.69
Top 15%	1.52	1.46	0.40	0.92	5.35
Bottom 5%	1.14	1.05	0.49	0.36	4.44
Bottom 10%	1.02	0.97	0.30	0.38	2.65
Bottom 15%	0.96	0.93	0.24	0.42	2.13
<i>Panel D: Other</i>					
Average-to-minimum ratio	128,580.14	3,505.19	865,575.00	42.99	16,794,698

Notes: the statistics are reported across 847 destination-year observations where at least 100 firms export.

Figure D1: Heterogeneity in the tail index estimates of log-sales distributions across export destinations, a scatter plot, Peru.



Notes: The figure depicts a scatter plot of the right and left tail index estimates for for the top and bottom 5% of firms. Each dot in the figure corresponds to an estimate of the right and left tail indexes for a given destination-year observation. A sample of 415 destination-year observations where at least 100 first export.

Figure D2: Goodness of fit statistics across each destination-year observation, Peru.

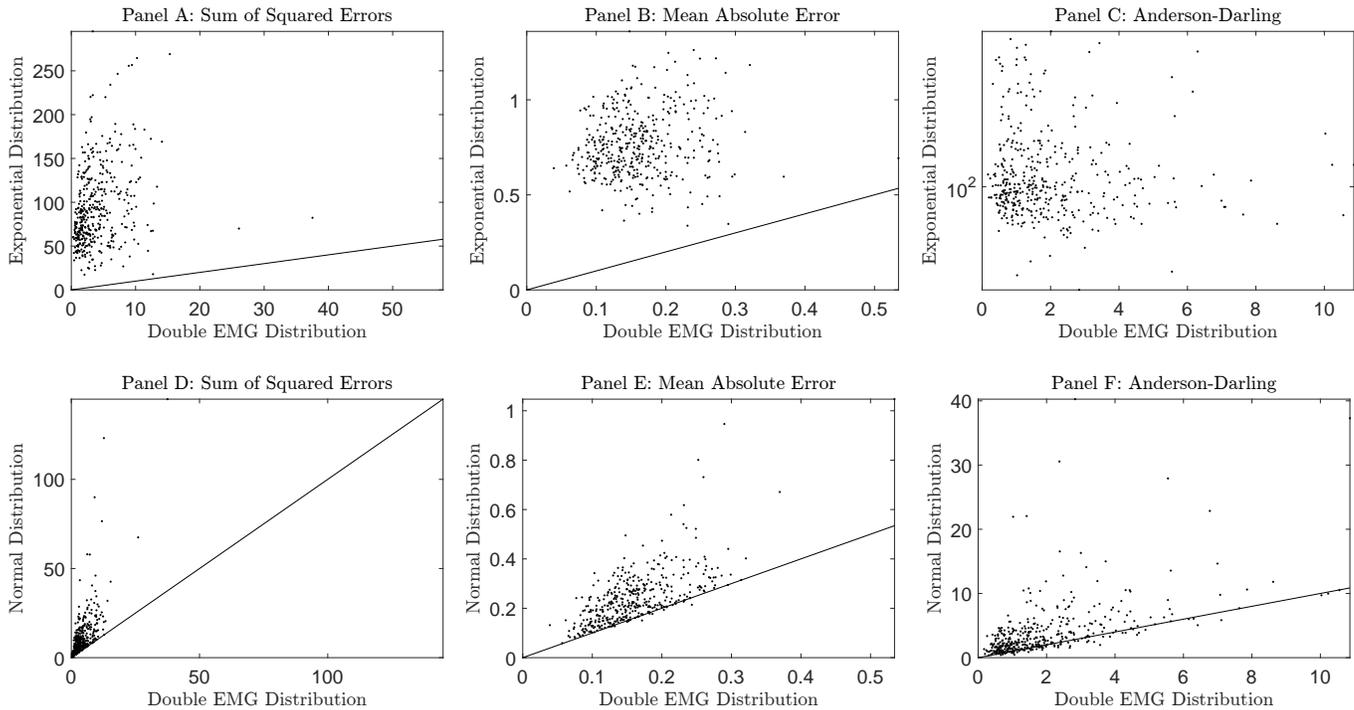


Figure D3: Goodness of fit statistics across each destination-year observation, sample selection robustness.

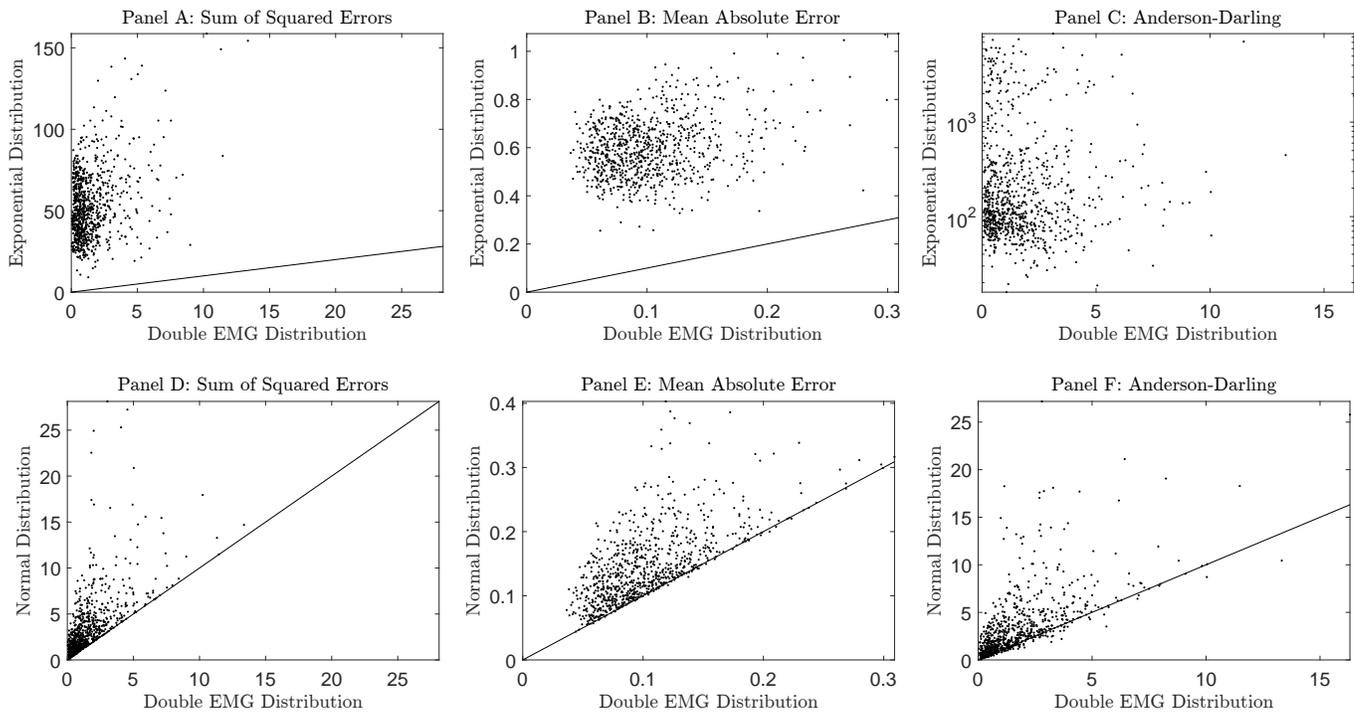


Figure D4: Goodness of fit statistics across each destination-year observation, industry composition robustness.

